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TRANSCRIPT OF RECORD

SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1932

No. 95

DAVID BURNET, COMMISSIONER OF INTERNAL REVENUE, PETITIONER

vs.

COMMONWEALTH IMPROVEMENT COMPANY

ON WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE THIRD CIRCUIT

PETITION FOR CERTIORARI FILED MAY 20, 1933

CERTIORARI GRANTED MAY 31, 1933

SUPREME COURT OF THE UNITED STATES

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Before United States Board of Tax Appeals

Docket No. 24959

COMMONWEALTH IMPROVEMENT COMPANY, PETITIONER

v.

COMMISSIONER OF INTERNAL REVENUE, RESPONDENT

Appearances: For petitioner, E. A. Ballard, Esq., Wm. R. Spofford, Esq., Schofield Andrews, Esq.; for respondent, John D. Foley, Esq.

Docket entries

Mar. 7, 1927. Petition received and filed. Taxpayer notified.
Mar. 8, 1927. Copy of petition served on general counsel.
May 7, 1927. Motion for extension to 7/7/27 to file answer filed by general counsel.
May 10, 1927. Granted. Both sides notified.
July 7, 1927. Answer filed by general counsel.
July 8, 1927. Copy of answer served on taxpayer—General Calendar.
Apr. 23, 1929. Hearing set 6/19/29.
2 June 19, 1929. Hearing had before Logan Morris, Division 14, on merits. Petitioner's motion to continue to October granted.
June 19, 1929. Order placing on General Calendar for hearing fall term, 1929, entered.
Aug. 5, 1929. Hearing set 10/8/29.
Oct. 8, 1929. Hearing held before Percy W. Phillips, Division 11, on the merits. Briefs due in 60 days.
Oct. 21, 1929. Transcript of hearing 10/8/29 filed.
Dec. 6, 1929. Brief filed by taxpayer.
Dec. 7, 1929. Brief filed by general counsel.
Oct. 9, 1930. Findings of fact and opinion rendered, P. W. Phillips, Division 11. Decision will be entered for respondent.
Oct. 9, 1930. Decision entered, Percy W. Phillips, Division 11.
Apr. 6, 1931. Petition for review by U. S. Circuit Court of Appeals (3), with assignments of error filed by taxpayer.
Apr. 6, 1931. Proof of service filed.
May 6, 1931. Statement of evidence lodged.
May 6, 1931. Præcipe filed.
May 6, 1931. Proof of service of præcipe and statement of evidence with hearing notice 5/20/31 filed.
May 19, 1931. Statement of evidence approved and ordered filed.

3 Before United States Board of Tax Appeals

[Title omitted.]

Petition

Filed March 7, 1927

The above-named petitioner hereby petitions for a redetermination of the deficiency set forth by the Commissioner of Internal Revenue in his notice of deficiency (IT:E:SM–60D–AJL–C–30211), dated January 13, 1927, and as a basis of its proceeding alleges as follows:

1. The petitioner is a corporation organized and existing under the laws of Pennsylvania, with its principal office at 405 Land Title Building, Philadelphia, Pennsylvania.

2. The notice of deficiency (a copy of which is attached and marked "Exhibit A") was mailed to the petitioner on January 13, 1927.

3. The taxes in controversy are income and profits taxes for the calendar year 1920 and are for $294,388.42.

4. The determination of tax set forth in the said notice of deficiency is based upon the following errors:

4 (a) The respondent has increased petitioner's net income by $1,055,953.12, alleged profit upon the transfer in 1920 of 225,000 shares of British-American Tobacco stock by the petitioner to its sole stockholder, the estate of P. A. B. Widener, deceased.

5. The facts upon which the petitioner relies as the basis of this proceeding are:

(a) During 1920, and for many years prior thereto, all of petitioner's capital stock was owned by the estate of P. A. B. Widener. At the time of the transfer of British-American shares above referred to the said estate also owned all of petitioner's outstanding bonds ($4,000,000 face value) and had a book claim against petitioner of $250,417.78 on open account.

(b) During 1920 the trustees of the estate of P. A. B. Widener were Joseph E. Widener and George D. Widener, and they, with Ellis Ames Ballard, counsel for the estate, were also directors and officers of the petitioner, being, respectively, president, vice president, and secretary treasurer.

(c) On March 18, 1920, the trustees caused the petitioner to transfer to the estate 225,000 shares of British-American Tobacco Company stock having a market value at that time of 23½ per share, or $5,287,500. In order to balance the books of the estate and the petitioner, the trustees then caused the estate to surrender all of petitioner's bonds ($4,000,000) face value to cancel its open account of $250,417.78 to transfer to the petitioner sundry stocks having a value of $299,287.78 and to settle the balance of $737,794.44 by book credit in favor of petitioner.

5 (d) The 225,000 shares of British-American Tobacco Company stock were acquired by the petitioner from the late P. A. B. Widener in 1912 at a book cost of $3,966,002, the petitioner having

then issued its securities to Mr. Widener in payment therefor. The value on March 1, 1913 (which is not disputed by the respondent) was $5,315,625, or $23⅝ per share. In 1919 the petitioner acquired the right to subscribe to new shares to the extent of one-third of its holdings. This right was exercised by the payment of $326,437.50. In accordance with the regulations of respondent then in effect, the petitioner was not required and therefore did not attempt to find a quotient value for each share by averaging the sum of the March 1, 1913, value plus the subscription price paid in 1919, but applied the March 1, 1913, value, $5,315,625 (being, as aforesaid, the value of the 225,000 shares first acquired) against the transfer price of $5,287,500 which resulted in a book loss of $28,125.

(e) Subsequent to the filing of the 1920 income and profits tax return and the payment of the tax shown to be due thereon, Treasury Decision 3402 (approved October 18, 1922) was issued. The application of the averaging method contained in this decision and the resulting quotient figure reduce the basis of the 225,000 shares of British-American Tobacco Company stock to $4,231,546.88, upon which the respondent has computed a taxable profit of $1,055,953.12.

Wherefore, the petitioner prays that this board may hear the proceeding and determine that no part of the bookkeeping profit of $1,055,953.12 realized in the transfer of 225,000 shares of
6 British-American Tobacco Company stock constitutes taxable income to the petitioner.

(Sgd.) WM. R. SPOFFORD,
Counsel for Petitioner,
1035 Land Title Bldg., Philadelphia, Pa.

[*Duly sworn to by Ellis A. Ballard; jurat omitted in printing.*]

7 *Exhibit A to petition*

TREASURY DEPARTMENT,
OFFICE OF COMMISSIONER OF INTERNAL REVENUE,
Washington, Jan. 13, 1927.

IT:E:SM–60D
AJL–C30211

COMMONWEALTH IMPROVEMENT CO.,
405 Land Title Bldg., Philadelphia, Pa.

SIRS: An audit of your income and excess-profits tax return for the calendar year 1920 has resulted in the determination of a deficiency in tax of $294,388.42, as shown in the attached statement.

In accordance with the provisions of section 274 of the revenue act of 1926, you are allowed 60 days from the date of mailing of this letter within which to file a petition for the redetermination of this deficiency. Any such petition must be addressed to the United States Board of Tax Appeals, Earle Building, Washington, D. C., and must be mailed in time to reach the board within the 60-day period, not counting Sunday as the sixtieth day.

Where a taxpayer has been given an opportunity to file a petition with the United States Board of Tax Appeals, and has not done so within the 60 days prescribed, and an assessment has been made or where a taxpayer has filed a petition and an assessment in accordance with the final decision on such petition has been made, the unpaid amount of the assessment must be paid upon notice and demand from the collector of internal revenue. No claim for abatement can be entertained.

8 If you acquiesce in this determination and do not desire to file a petition with the United States Board of Tax Appeals, you are requested to execute a waiver of your right to file a petition with the United States Board of Tax Appeals on the inclosed Form A and forward it to the Commissioner of Internal Revenue, Washington, D. C., for the attention of IT:E:SM–60D, AJL–C–30211. In the event that you acquiesce in a part of the determination, the waiver should be executed with respect to the items to which you agree.

Respectfully,

D. H. BLAIR,
Commissioner.

(Signed) C. R. NASH,
Assistant to the Commissioner.

Inclosures:
Statement.
Form A.
hlc–l.

9 STATEMENT

JAN. 13, 1927.

In re: Commonwealth Improvement Co., 405 Land Title Bldg., Philadelphia, Pa.

1920—Deficiency in tax, $294,388.42

Reference is made to your protests dated Sept. 28, 1926, and Oct 22, 1926, against adjustments made by the bureau relating to the following items in the determination of your net income for the year 1920, as set forth in bureau letter dated Sept. 24, 1926:

(a) Dividends received from foreign corporations	$234,779.55
(b) Profit on sale of British-American Tobacco Co. Stock	$1,055,953.12

After careful review of your protest and of all the evidence submitted in support of your contentions, you are advised that the bureau holds as follows relative to the protested items.

The protest of September 28, took exception to Item 4, "Dividends received from foreign corporations, $234,779.55." This issue has now been allowed as noted below.

The protest of October 22, 1926, raises the same contention in respect to the above dividends, also takes exception to item 2, "Profit on sale of British-American Tobacco Company stock, $1,055,953.12." This item was considered in previous conferences held in this office under dates of January 20, 1925 and February 14, 1925, at which time you were requested to submit additional information. The data submitted in your brief of October 22, 1926, is held to be inadequate to allow your contention.

The Unit holds the following computation as indicating the profit to be reported as income:

10 You purchased 225,000 shares of stock for $3,966,002.00 prior to March 1, 1913. The March 1, 1913, value was $5,315,625.00. In 1919 you received the right to subscribe to one share for each three shares held. 75,000 shares were purchased at $4.3525, or a total of $326,437.50. You transferred 225,000 shares to the Widener estate at market 23½, or $5,287,500.00. In the 1920 return filed you show selling price of $5,287,500.00 against which is applied $5,315,625.00 (225,000 shares at 23⅝ths. This is the March 1, 1913, value of shares based on 1913 quotations, but does not take into consideration the shares subscribed for under "rights."

Treasury Decision 3402, approved October 18, 1922, amended the basis of computing cost of stock sold when a part of the stock was acquired under subscription rights. The March 1, 1913, value of 225,000 shares was $5,315,625 to which was added 75,000 shares costing $326,437.50. This resulted in 300,000 shares at $5,642,062.50. The quotient cost under Treasury Decision 3402 is 18.806875 instead of 23⅝ths. This results in a profit of $1,055,953.12 instead of the loss claim by you. The selling price at market at 23½ for the 225,000 shares was made up by the purchaser by a cancellation of the $4,000,000.00 in bonds, the transfer of securities belonging to the estate, together with the obligation to pay the balance in cash.

Recomputation of your tax liability under Section 328 results in an amended deficiency in tax of $294,388.42 determined as follows:

ADJUSTMENTS TO NET INCOME

Net loss reported on return		$62,283.59
Add:		
(1) Profit on sale of scrip	$28,500.00	
(2) Profit on sale of British-American Tobacco Co. stock	1,055,953.12	
11 (3) Loss reported on same	28,125.00	
(4) Dividends received from foreign corporations	101,292.26	
		1,213,870.38
Total additions		$1,151,586.79
Less:		
(5) Refund, 1918	1,709.21	
(6) Taxes allowed	8,290.79	
		$10,000.00
Adjusted net income		$1,141,586.79

EXPLANATION OF ADJUSTMENTS TO NET INCOME

(1) To reflect profit on sale of scrip. This scrip was received in 1919 at a face value of $30,000.00, and was sold during 1920 for $58,500.00. The gain is held to be income for 1920.

(2) Profit on sale of British-American Tobacco stock in accordance with Treasury Decision 3402, which reads in part as follows:

"Whereas the stockholder exercises his right to subscribe to new stock of substantially the same character or preference as the stock with respect to which the right is issued, the cost of the old and new shares (or if acquired prior to March 1, 1913, the fair market value as of that date) will be the quotient cost of the old shares plus the subscription price of the new shares, divided by the total number of the old and new shares."

225,000 shares at March 1, 1913, value (23⅝)		$5,315,625.00
75,000 shares acquired through right to subscribe in 1919, 4.34¼		326,437.50
300,000		$5,642,062.50
12	Quotient cost per share	18.806875
	225,000 shares sold for 23½	$5,287,500.00
225,000 shares cost at 18.806875		4,231,546.88
	Profit	$1,055,953.12

(3) To adjust for loss on this item deducted on the return.

(4) To restore to income the dividends received from foreign corporations. The records of this office disclose that a return was filed by the Imperial Tobacco Company for each of the years 1918, 1919, and 1920, but the taxes paid for 1920 were refunded, as it was held that no taxable income was received during 1920 from sources within the United States. The dividends, therefore, received from this corporation are held to be taxable income. Since the returns of the British-American Tobacco Company and the Anglo-American Oil Company disclose that these corporations received income subject to tax from sources within the United States, dividends received from these corporations are not subject to tax.

(5) To adjust for refund for 1918 which was credited to taxes paid instead of to surplus.

(6) To adjust for taxes charges to surplus on books, which were allowed as deductions by agent. The contention relative to the stock dividend of Garland Stock in the amount of $22,500.00 is conceded and this item is omitted from income in this audit.

COMPUTATION OF TAX

Profits tax, section 328			$282,824.96
Net income		$1,141,586.79	
Less:			
13 Profits tax	$282,824.96		
Exemption	2,000.00		
		$284,824.96	
Amount taxable at 10%		856,761.83	$85,676.18
Correct tax liability			368,501.14
Credit for taxes paid to Great Britain			74,112.72
Total tax assessable			294,388.42
Previously assessed			None.
Deficiency in tax			294,388.42

Inasmuch as a hearing has already been held in the bureau in the matter of the profit on sale of British-American Tobacco Company stock, $1,055,953.12, and all information submitted in connection therewith carefully considered, your request for another conference can not be granted.

A copy of this letter is being forwarded to your authorized representative, Mr. Schofield Andrews, of Ballard, Spahr, Andrews and Madeira, 1035 Land Title Building, Philadelphia, Pennsylvania.

hlc-l

14 Before U. S. Board of Tax Appeals

Answer

Filed July 7, 1927

The Commissioner of Internal Revenue, by his attorney, A. W. Gregg, general counsel, Bureau of Internal Revenue, for answer to the petition heretofore filed by the above-named petitioner, admits and denies as follows:

1. Admits the allegations of paragraph numbered 1.
2. Admits the allegations of paragraph numbered 2.
3. Admits the allegations of paragraph numbered 3.

5(a). Admits the allegations of subparagraph (a) of paragraph 5.

(b) For lack of information upon which to base a belief, he denies the allegations of subparagraph (b) of paragraph 5.

(c) Answering the allegations of subparagraph (c) of paragraph 5, he admits that the petitioner transferred to the estate of P. A. B. Widener on March 18, 1920, 225,000 shares of British-American Tobacco Company stock having a market value at the time of $23.50 a share, or $5,287,500. Admits that the trustees of the estate of P. A. B. Widener surrendered to the petitioner its bonds of a face value of $4,000,000, that they cancelled an open account due from petitioner to said estate in the amount of $250,417.78, that they trans-

ferred to petitioner sundry stocks having a value of $299,287.78,
15 and that the balance was settled by a book credit of $737,-794.44 in favor of petitioner. Denies the remaining allegations of subparagraph (c) of paragraph 5.

(d) Answering the allegations of subparagraph (d) of paragraph 5, he admits that 225,000 shares of British-American Tobacco Company stock were acquired by petitioner from the late P. A. B. Widener in 1912, but is not advised of the book cost of said stock, and therefore denies that it was $3,966,002 or any amount. Admits that the value of this stock on March 1, 1913, was $5,315,625, or $23⅝ a share. Admits that in 1919 petitioner acquired the right to subscribe for new shares to the extent of one-third of its holdings. Admits that this right was exercised by the payment of $326,437.50. Denies the remaining allegations of subparagraph (d) of paragraph 5.

(e) Admits the allegations of subparagraphs (e) of paragraph 5.

Denies generally and specifically each and every allegation not hereinbefore admitted, qualified, or denied.

Wherefore it is prayed that said petition be denied.

A. W. GREGG,
General Counsel, Bureau of Internal Revenue.

Of counsel:

JOHN D. FOLEY,
Special Attorney, Bureau of Internal Revenue.

16 Before U. S. Board of Tax Appeals

Findings of fact and opinion

Promulgated October 8, 1930

1. The original cost of stock, with respect to which stock rights have been received and exercised, must be adjusted to give effect to the acquisition of the new stock in determining the basis for computing gain or loss upon the sale of a portion of such stock. Miles v. Safe Deposit Co., 259 U. S. 247, and Frederick Ayer, 6 B. T. A. 152; affd., 25 Fed. (2d) 534, followed.

2. The sale of securities by a corporation to its sole stockholder at a price in excess of cost and March 1, 1913, value results in taxable gain.

Ellis Ames Ballard, Esq., William R. Spofford, Esq., and Schofield Andrews, Esq., for the petitioner.

John D. Foley, Esq., for the respondent.

Respondent has determined a deficiency against petitioner of income and profits taxes for the calendar year 1920 in the amount of $294,388.42. The error alleged is that respondent has increased petitioner's net income by $1,055,953.12, alleged profit from the trans-

fer in 1920 of 225,000 shares of British-American Tobacco stock by petitioner to its sole stockholder, the estate of P. A. B. Widener, deceased.

Findings of fact

Petitioner is a corporation organized and existing under the laws of Pennsylvania, with its principal office at 405 Land Title Building, Philadelphia, Pennsylvania.

In 1911 P. A. B. Widener was a large stockholder in the Standard Oil Company and the American Tobacco Company. In 1911 these companies were dissolved pursuant to a decree of the Supreme
17 Court of the United States. Under this dissolution there came into the hands of P. A. B. Widener stock of companies incorporated in many of the different States and in Great Britain and having a value of about $20,000,000. P. A. B. Widener was then about eighty years of age and his affairs were attended to by his son, George D. Widener. Counsel for P. A. B. Widener advised George D. Widener that death duties upon his father's estate could be avoided to a certain extent by putting all of his securities, other than those of Pennsylvania corporations, into a Pennsylvania corporation. Upon being approached on the subject P. A. B. Widener rejected the plan.

George D. Widener was lost on the "Titanic" on April 12, 1912. In the meantime P. A. B. Widener had purchased at a cost of some $3,000,000 to $4,000,000 a large tract of land in Philadelphia and built thereon the Widener Memorial School for Crippled Children, hereafter referred to as the Charity. After the death of George D. Widener, P. A. B. Widener sent for his counsel and stated that he then had no one to advise him and that he was anxious to create a safe endowment for the Charity. He stated to counsel that he desired the endowment to be $4,000,000 and that he might raise it to $5,000,000, and he desired to place a lien upon his whole fortune to secure the endowment. Counsel advised Widener that under the laws of Pennsylvania this plan was not feasible, but that Widener might transfer to petitioner all of his non-Pennsylvania securities, and against these securities have petitioner issue debentures which would serve the purpose of the endowment. Widener told counsel to proceed accordingly. All of Widener's non-Pennsylvania securities, except one share of United States Steel, which was reserved in order to qualify Widener as a director in that corporation, were transferred as of May 1, 1912, to petitioner in consideration
18 of $5,000,000 of capital stock, $5,000,000 of script convertible into capital stock at the option of petitioner, first 4 per cent debentures in the amount of $5,000,000, and 6 per cent debentures in the amount of $10,000,000. The whole issue of stocks and bonds aggregating $25,000,000 par value thus became the property of Widener. Subsequently, in 1912, a deed of trust was executed and

$4,000,000 of the $5,000,000 first 4 per cent debentures were delivered to the Land Title and Trust Company of Philadelphia to hold the same in perpetuity as an endowment for the Charity.

P. A. B. Widener died testate in the year 1915. After making certain devises and legacies, practically the whole of the estate of Widener was by his will left in a long term trust. The Charity was not mentioned in the will and received nothing thereunder. The estate of Widener consisted of securities of Pennsylvania corporations, including the stock in petitioner; some real estate; his qualifying share in the United States Steel Corporation; and his collection of pictures, which eventually will go to the city of Philadelphia. All his interest in non-Pennsylvania corporations had, as above set forth, been conveyed to petitioner and was at the date of his death owned by it. No death taxes were paid to any of the States other than Pennsylvania upon the non-Pennsylvania stocks or securities by reason of the death of P. A. B. Widener.

The executors and trustees under the will of Widener were his surviving son, Joseph E. Widener, and his grandson, George D. Widener, son of testator's deceased son, George D. Widener. The directors and officers of petitioner were said Joseph E. Widener, said George D. Widener, grandson of P. A. B. Widener, and one Ballard. Ballard has been secretary and treasurer of petitioner since May 1, 1912, was counsel for P. A. B. Widener until his death and later for his estate. Ballard has received no compensation as coun-
19 sel for the estate, but he receives annually from petitioner the sum of $20,000, which covers both his services as secretary and treasurer of petitioner and also his services as counsel for the estate. The trustees have not received commissions from the estate, but each has been paid annually the sum of $25,000 as salary as an officer of petitioner. In 1920 and for many years prior thereto the clerks and bookkeepers of the estate and the office expenses were paid by petitioner. At times when petitioner or the estate was in need of funds or either desired stock to hypothecate, and it seemed more desirable that the transaction should be in the one name or the other, transfers would be made and proper entries made on the books of both.

Two years after the death of P. A. B. Widener petitioner's capital structure was reduced to $2,000,000 capital stock and $4,000,000 of debentures, being the same debentures deposited with the trustee for the Charity. The issues of $10,000,000 6 per cent debentures, $1,000,000 of the 4 per cent debentures, $3,000,000 of stock, and $5,000,000 of script was cancelled and cremated. This was accomplished by transferring from petitioner to the trustees of the estate securities of value equal to the securities cancelled, and if there was a difference in value it was entered on the books of each as a credit or debit, as the case might be.

The trustees of the estate of Widener continued to hold all petitioner's stock except the qualifying shares of the directors, which

were in fact owned by the estate. The trustee for the Charity held the $4,000,000 debentures until 1920. In that year the trustees of the estate desired to substitute for these debentures certain real estate bonds on properties owned by the estate of Widener. To this the trustee for the Charity consented, and the substitution was made. In this way the estate of Widener became the owner of $4,000,000 of debentures, which constituted a claim in favor of the estate against the petitioner.

20 In 1920 the trustees of the estate transferred to petitioner these debenture bonds of the value of $4,000,000 and sundry stocks of a value of $299,287.78, cancelled an open account due said estate from petitioner of $250,417.78, and credited petitioner on its books with $737,794.44. In exchange therefor petitioner transferred to the estate 225,000 shares of stock of the British-American Tobacco Company of a market value of $23.50 per share, or a total value of $5,287,500, and charged the estate with the balance of $737.794.44. Two hundred and twenty-five thousand shares of the British-American Tobacco Company stock were acquired by petitioner from P. A. B. Widener in 1912 at a cost of $3,966,002. The value of said shares on March 1, 1913, was $5,315,625, or $23.625 per share. In 1919 petitioner acquired the right to subscribe for new shares of the British-American Tobacco Company to the extent of one-third of its holdings, and exercised this right by the payment of $326,437.50, increasing its holdings to 300,000 shares and making the average cost $18.806875 per share, and upon this basis respondent has computed the gain on the transfer above set forth. The certificates transferred were those which evidenced the original holding of 225,000 shares.

Joseph Widener, who was the president of petitioner and one of the trustees of the estate, told Ballard that he desired to make the substitution of securities in the Charity's endowment above set forth. Ballard, as secretary and treasurer, arranged the transaction and wrote it up on the minutes, which were approved by the other directors. Every year Ballard received proxies from the stockholders of record. He held the meetings in his office and wrote up the minutes. There never has been a meeting of the stockholders or directors in which the stockholders and directors sat around a table and made motion or passed resolutions. The consultations between officers and stockholders have been informal.

21 *Opinion*

PHILLIPS:

Petitioner makes the following contentions: (1) That it and the estate of P. A. B. Widener (hereafter referred to as the estate) are one and the same entity and neither gain nor loss can result from transactions between them, and (2) that the March 1, 1913, value as

a basis for determining gain or loss upon the stock sold by petitioner should not be affected or decreased by the exercise of stock rights at a subsequent date.

While the petitioner does not present any argument upon the second point, some explanation is necessary to understand the manner in which the controversy arises. In 1911 or 1912 petitioner acquired 225,000 shares of the stock of British-American Tobacco Company at a cost of $3,966,002. On March 1, 1913, these shares had a value of $5,315,625. In 1919 the petitioner received stock rights which it exercised, acquiring 75.000 additional shares at a cost of $326,437.50. In 1920 it sold 225,000 shares to the estate for $5,287,500, which was their market value on the date of sale. Upon its income-tax return petitioner claimed a loss of the difference between the selling price and a March 1, 1913, value of $5,315,625. The commissioner made the following adjustment in the cost or March 1, 1913, value:

225,000 shares; March 1, 1913, value	$5, 315, 625. 00
75,000 shares; acquired on exercise of stock rights for	326, 437. 50
300,000 shares	$5, 642, 062. 50
1 share	18. 806875
225,000 shares	$4, 231, 566. 88

22 The application of the averaging method of computing the cost basis for determining gain or loss on the sale of stocks with respect to which there have been stock dividends or subscription rights has been approved by the courts and this board in Miles v. Safe Deposit Company, 259 U. S. 247, and Frederick Ayer, 6 B. T. A. 152, affirmed, 25 Fed. (2d) 534. By reason of the application of this principle the commissioner has determined that there was a profit to petitioner of $1,055,953.12 on the sale of this stock instead of a loss of $28,125 as claimed by petitioner upon its return. The petitioner does not now argue before the board that the method of computing the gain was incorrect, but relies entirely upon its contention that the corporation and the estate are the same entity. If this contention were logically applied it would follow that all income received by the corporation since its organization was properly taxable as income of P. A. B. Widener and his estate and should have been added to any other income which Widener and his estate received during these years and taxed at the rates applicable to individuals rather than returned by the petitioner and taxed at the rates fixed for corporations. For the purposes of inheritance and transfer taxes imposed by the various States upon the transfer of the stocks owned by petitioner the corporate entity should have been disregarded upon the death of Widener and these stocks subjected to whatever taxes would have been payable had they been owned by the decedent. But petitioner does not seek to carry its contention to such a conclusion. Having enjoyed the benefits which resulted from its separate existence, it seeks to perpetuate those benefits and asks that the separate existence and tax liability of the

petitioner and its single stockholder be overlooked only with respect to transactions which take place between them. That this is an afterthought is plainly evidenced by the action of petitioner in claiming a deduction upon this same transaction when it believed a deductible loss had been sustained.

23 Stress is laid upon the purpose for which petitioner was created. It seems to us immaterial whether the purpose was to avoid inheritance and transfer taxes or to permit the entire estate of decedent to stand as security for the endowment of the Charity in which decedent was interested. "What was done, rather than the design and purpose of the participants, should be the test." United States v. Phellis, 257 U. S. 156. If we are mistaken and the purpose is of importance, it may be pertinent to note that this second purpose had been entirely avoided by the time the transaction with which we are dealing took place. The trustees of the estate had convinced the trustees of the Charity that mortgage bonds were as desirable as the debenture bonds issued by petitioner and the Charity had exchanged such debentures. Neither of the purposes mentioned above justified the continued separate existence of petitioner at the time the stock here in question was sold and some other reason must have existed for its continuance. As we have said before, the reason seems immaterial. The fact is that petitioner did have a separate legal existence with privileges and obligations entirely separate from those of its stockholders. The fact that it had only one stockholder seems of no legal significance. Cannon Mfg. Co. v. Cudahy Co., 267 U. S. 333.

Under the facts set forth in our findings of fact we are asked to look through the form to the substance, to disregard the corporate entity, and to hold that the estate was in fact the owner of the stock of the British-American Tobacco Company. In support of this contention petitioner relies upon Southern Pacific Company v. Lowe, 247 U. S. 330, and Gulf Oil Corporation v. Lewellyn, 248 U. S. 71. In these cases the Supreme Court held that taxable income did not result from what they termed in the first case a "paper" and in the second case a "bookkeeping" transaction. Here we have

24 no mere bookkeeping or paper transaction, but the actual transfer of securities and the payment of a debt. The situation is not unlike those presented in United States v. Phellis, supra, and Rockefeller v. United States, 257 U. S. 176. In each of those cases it was held that stockholders of a corporation received taxable income, although after the transaction the stockholders held the same equities in the same properties as before. In the instant case the petitioner may have been no richer after the transaction than before, but the same is true of every transaction in which one sells property for its then value. It is because one sells property for more than its cost that a taxable gain results. Here petitioner sold property for more than its cost and after the transaction it had something different from that which it had before. That the transaction was with the estate which owned all its capital stock is not

material unless we are not to regard the separate entities of a corporation and its stockholders in transactions between them. That such is not the law seems settled by the cases cited.

Petitioner cites decisions which it is said disregard the separate entities where necessary to prevent fraud or injustice. Rubay Company, 9 B. T. A. 133; Franklin O. Brown, 9 B. T. A. 965. An analysis of those cases will, we believe, disclose that separate entities were not disregarded. In each of those cases the form of the transaction was not representative of the result accomplished and effect was given to the true situation and not to that depicted by form. Here there is no such case. Securities were sold at their market value and payment received. The form which the transaction took truly represents the transaction which took place.

The contention that the estate was neither richer nor poorer because of this transaction by reason of the ownership of the stock of petitioner is not new. It has been advanced in different forms to meet different states of facts. Thus, it has been asserted that
25 where upon the dissolution of a corporation the stockholders received its assets in proportion to their stockholdings, no income was realized for the reason that the stockholders were at all times the owners of the assets and thus no richer in the evening than they were in the morning of the day the transaction occurred. This contention was denied in E. C. Huffman, supra; John K. Greenwood, supra; Estate of D. F. Buchmiller, 1 B. T. A. 380; J. H. Morrow, Administrator, 1 B. T. A. 1148, and Joseph Joseph et al., 6 B. T. A. 595.

Although the state owned all of petitioner's stock, the transfers involved were made upon the basis of the true value of the securities exchanged and the debt extinguished, and therefore the bona fides of the transaction is not challenged. Neither does this transaction constitute a capital contribution by the estate to petitioner. The estate and petitioner each received full value. The gain of petitioner arises from the sale and exchange of capital assets, and is therefore taxable income, as defined in Eisner v. Macomber, 252 U. S. 189. See Nixon v. Lucas, Fed. (2d) , (C. C. A. 2d, July 7, 1930).

Reviewed by the board.

Decision will be entered for the respondent.

26 Before U. S. Board of Tax Appeals

Decision

Filed October 9, 1930

Pursuant to the board's findings of fact and opinion, promulgated October 8, 1930, it is

Ordered and decided that there is a deficiency for the year 1920 in the amount of $294,388.42.

(Sgd.) PERCY W. PHILLIPS,
Member United States Board of Tax Appeals.

In United States Circuit Court of Appeals

Petition for review of decision of United States Board of Tax Appeals

Filed April 6, 1931

To the Honorable the Judges of the United States Circuit Court of Appeals for the Third Circuit:

Your petitioner on review, Commonwealth Improvement Company, by its attorney, William R. Spofford, in support of this its petition filed in pursuance of section 1001 of the act of Congress approved February 26, 1926, entitled the "Revenue act of 1926" (44 Stat. 9), for review of the decision of the United States Board of Tax Appeals rendered on October 8, 1930, and the order entered on October 9, 1930, determining a deficiency in income and profits taxes for the calendar year 1920 in the amount of $294,388.42, respectfully shows:

Your petitioner on review is a corporation organized and existing under the laws of the Commonwealth of Pennsylvania, with its principal office at 405 Land Title Building, Philadelphia, Pennsylvania.

The respondent on review is the duly appointed, qualified,
27 and acting Commissioner of Internal Revenue of the United States, holding his office by virtue of the laws of the United States.

STATEMENT OF THE NATURE OF THE CONTROVERSY

1. The Commissioner of Internal Revenue determined a deficiency in income and profits taxes for the calendar year 1920 in the amount of $294,388.42, and on January 13, 1927, in accordance with the provisions of section 274 of the revenue act of 1926, mailed a notice of said deficiency to the petitioner. On March 5, 1927, the petitioner filed with the United States Board of Tax Appeals a petition for a redetermination of the deficiency in income and profits taxes for the calendar year 1920 determined by the commissioner. Thereafter, in due course, the commissioner filed his answer to the petition. On October 7, 1929, which date is subsequent to the enactment of the revenue act of 1926, the cause duly came on for hearing before the Board of Tax Appeals, at which time petitioner offered oral testimony and documentary evidence in support of the allegations contained in the petition, and respondent offered no testimony.

2. The question for determination by the Board of Tax Appeals was whether or not under the circumstances of this particular case petitioner realized a taxable profit upon the transfer of certain shares of stock to its sole stockholder in 1920.

3. In 1920 petitioner owned 225,000 shares of British-American Tobacco Company stock acquired in 1912 at a cost of $3,966,002. The March 1, 1913, value was $23⅝ per share, or a total of $5,315,625.

In 1919 petitioner acquired 75,000 shares of the same stock by the exercise of subscription rights at a price of $326,437.50.

28 4. In 1920 all petitioner's outstanding stock, having an aggregate par value of $2,000,000, and all petitioner's outstanding bonds, consisting of debentures having an aggregate face value of $4,000,000, were owned by the estate of P. A. B. Widener.

5. Petitioner transferred 225,000 shares of British-American Tobacco stock to its sole stockholder in exchange for the surrender of $4,000,000 (all) of its debentures, sundry stocks valued at $299,287.78, and the creation of a book credit in favor of the petitioner amounting to $737,794.44, making a total consideration passing to petitioner of $5,287,500.

6. Under regulations of the Commissioner of Internal Revenue then in effect, and not changed until October 18, 1922, more than two years after the instant transaction was consummated, no profit was recognized on the transaction, as the identical shares held in 1913 were delivered in 1920 for a consideration slightly less than the 1913 value. By Treasury Decision 3402 the Commissioner of Internal Revenue changed his regulations and required taxpayers to determine an average cost per share for the stock first acquired and the stock acquired by subscription. Averaging the cost of 225,000 shares held on March 1, 1913, and 75,000 acquired in 1919 resulted in an adjusted average cost of $18.80 per share for the British-American Tobacco Company stock, or a total cost on this basis of $4,231,546.88 for 225,000 shares, on which respondent computed a taxable profit of $1,055,953.12.

7. Petitioner contended in the trial before the Board of Tax Appeals (a) that petitioner and the estate of P. A. B. Widener were one and the same entity, and neither gain nor loss could result from transactions between them, and (b) that the March 1, 1913,

29 value of the identical shares as a basis for determining gain or loss should not be affected or decreased by the exercise of stock rights at a subsequent date.

8. In support of its contentions, petitioner produced evidence before the Board of Tax Appeals to show the corporate and financial history of petitioner, the reason for its existence, its functions and the inseparability of petitioner and the estate of P. A. B. Widener, all of which appears in detail in the record, with the exception of certain evidence which was rejected and which rejections are the basis for assignments of error. Petitioner also produced evidence to show the purpose and real nature of the transaction under consideration.

9. On October 8, 1930, the Board of Tax Appeals rendered its findings of fact, together with an opinion, in which it denied both of petitioner's contentions and held that petitioner had realized a profit of $1,055,953.12 on the transaction. On October 8, 1930, a final order of redetermination was entered by the Board of Tax Ap-

peals approving the deficiency of $294,388.42 determined by the respondent.

DESIGNATION OF COURT OF REVIEW

Your petitioner, a Pennsylvania corporation, with its principal office in Philadelphia, duly filed its income and profits tax return for the calendar year 1920 with the collector of internal revenue for the first district of Pennsylvania at Philadelphia, Pennsylvania. Petitioner desires a review of the decision of the Board of Tax Appeals by the United States Circuit Court of Appeals for the Third Circuit.

ASSIGNMENTS OF ERROR

Your petitioner says that in the record and proceedings be-
30 fore the Board of Tax Appeals, and in the decision and final order of redetermination rendered and entered by the Board of Tax Appeals, manifest error occurred and intervened to the prejudice of your petitioner, and your petitioner hereby assigns the following errors, and each of them which it is averred occurred in the said record, proceedings, decision and final order of redetermination, and upon which it relies to reverse the said decision and final order of redetermination so rendered and entered by the Board of Tax Appeals, to wit:

1. The Board of Tax Appeals erred in holding that the petitioner realized a taxable profit of $1,055,953.12 from the disposition of 225,000 shares of British-American Tobacco Company stock which were transferred to its sole stockholder, the estate of P. A. B. Widener, deceased, in 1920.

2. The Board of Tax Appeals erred in not finding as a fact that the estate of P. A. B. Widener and the petitioner are one and the same.

3. The Board of Tax Appeals erred in not holding that neither gain nor loss results from transactions between the petitioner and the estate of P. A. B. Widener.

4. The Board of Tax Appeals erred in rejecting petitioner's offer to prove by the witness Ballard that in 1917 a profit of some $130,000 shown on paper as a result of the recapitalization Mr. Ballard described was conceded by the commissioner to be nontaxable, because the Commonwealth Improvement Company (petitioner) and the estate of P. A. B. Widener were identical.

5. The Board of Tax Appeals erred in rejecting petitioner's offer of proof as follows:

31 "I offer in evidence petitioner's Exhibit No. 2, report of the revenue agent dated June 29, 1921, with respect to the income tax for the year 1919, of the estate of P. A. B. Widener. This report shows that in that year the estate of P. A. B. Widener sustained a loss in transactions between it and the Commonwealth Im-

provement Company amounting to $167,883.59, and that such loss was denied to the estate of P. A. B. Widener for the reason that the estate of P. A. B. Widener and the Commonwealth Improvement Company (petitioner) were identical, and that a profit made by petitioner for the year 1917 had been held by the commissioner to be a nontaxable profit."

6. The Board of Tax Appeals erred in rejecting petitioner's offer of proof as follows:

"I offer in evidence as petitioner's Exhibit No. 3, certificate of overassessment 905088, issued to P. A. B. Widener, second, Joseph E. Widener, George D. Widener, executors and trustees of the estate of P. A. B. Widener, such certificate being for the year 1919, and being offered to show that action proposed in the revenue agent's report offered as petitioner's Exhibit No. 2 was affirmed by the commissioner."

7. The Board of Tax Appeals erred in not finding as a fact that it was not an essential part of the transaction between petitioner and its sole stockholder that 225,000 shares of British-American Tobacco Company stock should be transferred at $23.50 per share, and petitioner would have been willing to make the transfer to its sole stockholder at a lower price.

8. The Board of Tax Appeals erred in not finding as a fact that when Joseph E. Widener decided to make the exchange of real estate mortgages for debentures, consummation of the transaction was put in Mr. Ballard's hands and he selected the British-American Tobacco shares with which to make the transfer, because
32 this block of stock had remained unchanged from the date it was originally delivered by P. A. B. Widener and its value at that time (1920 was within one-eighth of the value on March 1, 1913, and he might have well selected a security which would have shown a greater paper profit, or a loss.

9. The Board of Tax Appeals erred in not finding as a fact that the details of the transaction involving the substitution of securities as an endowment for the charity and the transfer of 225,000 shares of British-American Tobacco Company stock were not discussed at any formal meeting of the directors of petitioner.

10. The Board of Tax Appeals erred in holding that the March 1, 1913, value of 225,000 shares of British-American Tobacco Company stock, to wit, $23⅝ per share, or $5,315,625, held by petitioner on that date should be decreased by reason of petitioner's exercise of stock rights in 1919, and the acquisition of 75,000 shares thereby at a cost of $326,437.50.

11. The Board of Tax Appeals erred in entering judgment for the respondent.

Wherefore your petitioner prays that the United States Circuit Court of Appeals for the Third Circuit may review said decision, opinion, and order of the United States Board of Tax Appeals, and

reverse and set aside the same, and enter an order directing the said Board of Tax Appeals to enter judgment of no deficiency for the petitioner, and your petitioner will ever pray.

(Sgd.) WM. R. SPOFFORD,
Attorney for Petitioner on Review,
1035 Land Title Building, Philadelphia, Pa.

33 [*Duly sworn to by Wm. R. Spofford; jurat omitted in printing.*]

34 Before United States Board of Tax Appeals

Docket No. 24959

COMMONWEALTH IMPROVEMENT COMPANY, PETITIONER ON REVIEW

v.

DAVID BURNET, COMMISSIONER OF INTERNAL REVENUE, RESPONDENT ON REVIEW

Statement of evidence

Filed May 19, 1931

The above-entitled cause came on for hearing before the Honorable Percy W. Phillips, member of the United States Board of Tax Appeals, on October 8, 1929. William R. Spofford, Esquire; Schofield Andrews, Esquire; and Ellis Ames Ballard, Esquire, appeared for Commonwealth Improvement Company, the taxpayer and petitioner before the Board of Tax Appeals, and John D. Foley, Esquire, for C. M. Charest, general counsel, Bureau of Internal Revenue, appeared for the Commissioner of Internal Revenue.

Thereupon, ELLIS AMES BALLARD, secretary and treasurer of the petitioner, having been called as a witness and having first been duly sworn, gave the following testimony:

My name is Ellis Ames Ballard. My address is City Line, Roxborough, Philadelphia, Pennsylvania. My occupation is attorney at law. I have been secretary and treasurer of the Common-
35 wealth Improvement Company since May 1, 1912. I was counsel for P. A. B. Widener up to his death in 1915 and have been counsel for his estate since his death. The Commonwealth Improvement Company has what in Pennsylvania is called a special charter granted prior to the adoption of the constitution of 1874. Since that date Pennsylvania corporations are limited to one specific object. Prior to that date the legislature granted to applicants what were called special omnibus charters, under which you could do almost anything, as you can to-day under a Delaware charter. The Commonwealth Improvement Company has one of those charters.

In 1911 the Supreme Court decreed the dissolution of the Standard Oil Company and the American Tobacco Company, in each of which P. A. B. Widener was a large stockholder, and as a result there came into his hands perhaps $20,000,000 worth of stock of corporations incorporated in many of the different States and in England, the latter being the place of incorporation of the British-American Tobacco Company, which is the stock that is specifically before you here. Mr. Widener was an old man and his affairs were attended to by his son, George D. Widener. I advised him, in order to avoid extraterritorial death duties, to put all his father's non-Pennsylvania securities into a Pennsylvania corporation if we could find an old charter available. He told me to find such an old charter, and I bought for Mr. Widener all the shares of the Commonwealth Improvement Company. He then suggested I talk with his father and see if I could get him to incorporate himself with respect to all his non-Pennsylvania holdings. It was a rather delicate subject, as he was an old man, perhaps 80, suggesting to him that when he died, which must be soon, he could save a very substantial sum in taxes which would be payable to jurisdictions to which I felt he owed no duty, such as Kansas, Oklahoma, California, and
36 Great Britain. He declined to do it. He said that there was enough money to pay the taxes and he would not do it. George D. Widener, under whose directions I had taken these steps, was lost on the "Titanic" on April 12, 1912. In the meantime P. A. B. Widener had bought a large tract of land in Philadelphia and built the Widener Memorial School for Crippled Children, at an expense of $3,000,000 or $4,000,000. He sent for me after George's death and said that he had no one now to look after his affairs; that he was anxious to create the safest endowment that he could for the school; and if I followed the plan which I had outlined to him several months before, could a lien be placed upon his whole fortune as an endowment for the school. He wanted $4,000,000 for this purpose and might later want to raise it to $5,000,000.

I told him that while there could not be a lien there could be a debenture issue which would be a first claim against the corporation. We do not have liens on personal property in Pennsylvania. I advised him to take up this charter and to put into the company all his non-Pennsylvania securities. He told me to go ahead and do it. I increased the capital of this company and provided for two issues of debentures. I made a list of all his non-Pennsylvania securities, putting upon them the then current market price, and we reorganized the company, which was an old company then out of business, with a capital of $5,000,000, all owned by P. A. B. Widener, with script of $5,000,000 convertible into capital stock at the option of the corporation, all owned by P. A. B. Widener, with an issue of 4 per cent first debentures of $5,000,000, all owned by P. A. B. Widener, and an issue of $10,000,000 6 per cent debentures, all owned by P. A. B. Widener ($25,000,000), and transferred into the name

of Commonwealth Improvement Company every share of stock owned by P. A. B. Widener issued by other than Pennsylvania corporations, with one exception. Mr. Widener was a director
37 of the United States Steel Company. He had to be a stockholder and one share of United States Steel preferred was left in his name, which I think is there yet. This transfer was effected May 1, 1912.

Mr. Widener died in 1915. His estate consisted of securities in Pennsylvania corporations, a little real estate, his collection of pictures, which eventually will go to the city of Philadelphia, and his interest in non-Pennsylvania corporations, all of which he held in the name of the Commonwealth Improvement Company. The directors and officers of that company were his surviving son, Joseph E. Widener, his surviving grandson, George D. Widener, who was the son of George D. Widener, who had perished on the "Titanic," and myself. Qualifying shares were in their names. These were indorsed and delivered to Mr. Widener, and there has been no transfer of stock from that date, May 1, 1912, to the present time. Every share of stock and every bond that was issued belonged to Mr. Widener. A deed of trust was drawn, and four million of the five million first 4 per cent debentures were delivered to the Land Title & Trust Company in Philadelphia, to hold the same in perpetuity as an endowment for the Widener Memorial School for Crippled Children. The deed of trust and delivery of those securities was effected immediately after May 1, 1912. The executors and trustees under the will of P. A. B. Widener are his son, Joseph E. Widener, and his grandson, George D. Widener. In 1915, and subsequently through the year 1920, I was counsel for the estate of P. A. B. Widener, but my compensation came to me as secretary-treasurer of the Commonwealth Improvement Company, through a salary of $20,000 a year, which I have drawn since 1912. Since 1920, when I formed a partnership, my salary has always been included as a fee in my office and divided under our partnership articles. Trustees of the estate
38 of P. A. B. Widener have not received commissions from the estate since their appointment to date, but each of them draws a salary of $25,000 as an officer of the Commonwealth Improvement Company. The clerks and bookkeepers employed in keeping the books of the estate of P. A. B. Widener were paid by the Commonwealth Improvement Company during 1920. All expenses of the office used by the estate of P. A. B. Widener are expenses of the Commonwealth Improvement Company, and the lease is in the latter's name. Commencing with the time of P. A. B. Widener's death in 1915, there were from time to time transactions between the estate of P. A. B. Widener and the Commonwealth Improvement Company. The general nature of the transactions was that as either part of the estate was in funds it might advance them to the other hand of the estate, or if it was desirable to have stock to sell, or perhaps to hypothecate, and it seemed more desirable to have it in the

names of the trustees of the estate than in the Commonwealth Improvement Company, transfers would be made and proper book entries would evidence that fact.

Two years after P. A. B. Widener's death we reduced the capital structure of the Commonwealth Improvement Company to $2,000,000 of stock and $4,000,000 of bonds, being the bonds deposited with the trustees for the Charity. We cancelled $10,000,000 of bonds (6 per cent debentures), $1,000,000 of bonds (4 per cent debentures), $3,000,000 of stock, and $5,000,000 of script, by transferring from the name of the Commonwealth Improvement Company to the name of the trustees securities equal in value to the securities of the Commonwealth Improvement Company cancelled. If there was any difference it was a charge entry.

Q. Do you recall, being treasurer of the Commonwealth Improvement Company, whether or not as a result of that transaction in 1917 it was claimed any time that the Commonwealth Improvement Company had incurred a liability for income tax because thereof?

39 Mr. FOLEY. I object to that as incompetent, irrelevant, and immaterial.

The MEMBER. Objection sustained.

Mr. ANDREWS. While I do not wish to show the commissioner at any time conceded the identity of the estate and the company and that a paper profit was not a taxable profit, I do not wish to show that to take the position that there is a technical legal estoppel now upon the commissioner to take a different attitude as respects the year 1920, nevertheless in a case like this, in which we have asked the board to look through the form and see the substance, any evidence showing a recognition of the identity is evidence which is relevant and material to the principal issue.

I can prove by this witness that in 1917 the commissioner conceded that a profit of some $130,000 shown on paper as a result of the recapitalization Mr. Ballard described was conceded by the commissioner to be nontaxable because the Commonwealth Improvement Company and the estate were identical.

The MEMBER. I think the objection to such testimony is well taken and will stand.

Mr. ANDREWS. Exception.

The MEMBER. Yes.

In 1920 Mr. Joseph E. Widener stated that they now had real-estate mortgages secured on the best property in Philadelphia which he would like to substitute as an endowment for the Widener Memorial School in place of the debenture bonds. About the time of Mr. Widener's death he had bought, or immediately after his death his son had bought, I am not sure which, the property on

40 which the Ritz-Carlton now stands in Philadelphia, at Broad and Walnut, and the old property on which the United States Mint stood on Chestnut Street and Juniper, next to the Wanamaker

store. Both of these properties are a short block from Broad and Chestnut, which is the center of Philadelphia real estate, and in 1920 mortgages secured thereon were in the hands of the estate.

The trustees of the estate exchanged the mortgages which they held with the trustees for the Charity for the four millions of debentures. Four millions of debentures were then held by that part of the estate which was unincorporated. They were claims against the part of the estate which was incorporated. The 1920 price of the British-American Tobacco stock was practically identical with the March, 1913, price, and as the identical 225,000 shares which had been delivered by Mr. Widener in 1912 to the Commonwealth Improvement Company as part of the consideration for the issue to him of all its stocks and bonds were held by the Commonwealth Improvement Company, the exchange was made. There were other entries on the books which you have described in your statement which were cleaned off at that time as being entries between two parts of the same entity, and the balance as shown by the figures used was set up as a debit and a credit between one and the other.

The four millions of Commonwealth Improvement Company debentures were surrendered by the trustees of the Widener estate to the Commonwealth Improvement Company as a part of this settlement. Mr. Widener and I went down to the basement and threw the debentures into the furnace.

Q. Mr. Ballard, was it an essential part of this transaction that the 225,000 shares of British-American Tobacco be transferred to the estate at $23.50 per share?

A. No.

41 Q. Would the Commonwealth Improvement Company have been willing to make that transfer at a lower price?

A. Yes.

Mr. FOLEY. I object to that as irrelevant and immaterial.

The MEMBER. Objection overruled.

Mr. FOLEY. Exception.

Mr. ANDREWS. Mr. Ballard, Mr. Widener having decided to make this exchange of real mortgages for debentures, in whose hands was the carrying through of the transaction placed?

A. Placed in mine.

Q. Will you describe again how it happened you gave the transaction exactly this form, namely, a transfer of British-American Tobacco shares?

A. This was a block of stock which had remained unchanged from the date it was delivered by Mr. Widener. It was the block of stock which has the same price or within one-eighth or one-fourth of it, of the March 1, 1913, price, and it seemed to be the line of the least resistance. I might well have selected a security which would have shown a greater paper profit, or a security which might have shown a loss.

Q. Was it left to your judgment in expressing this transfer on the books to pick the securities to be transferred and the transfer price to be expressed in the books?

A. It was certainly left to my judgment, with the bookkeeper and the broker to find out what the current price was. I would not have selected the securities without consulting with Mr. Widener, which I doubtless did.

At $23.50 per share 225,000 shares of British-American
42 Tobacco Company stock aggregate $5,287,500. The debentures to be cancelled had a face value of $4,000,000, and the Widener estate had a book account against the Commonwealth Improvement Company of $250,417.78, so that on the one hand, the estate had claims against the company aggregating $4,250,417.78 and the express transfer consideration of the shares of the British-American Tobacco Company was $5,287,500, leaving a considerable balance in favor of the Commonwealth Improvement Company. As a matter of bookkeeping the balance was set up as a debit and credit on the books, both the estate's side and the corporation's side of the estate. I recall that after these transfers were made there was a very considerable balance owed by the estate to the company and as both the estate's books and the company's books were accurately kept by accountants, those differences would be shown. You can go back over these years and you will find that at times the balance is on one side and at times the balance is on the other side.

I am a director of corporations other than the Commonwealth Improvement Company.

After Joseph E. Widener told me that he wanted to make the substitution of securities as an endowment for the Charity, I went ahead and I did it. I wrote up the transaction on the minutes, which were approved by the other directors, and George Mantz, who was the bookkeeper, made the bookkeeping entries.

Q. Do you recall whether or not the details of the transactions were discussed in a formal meeting of the directors of the Commonwealth Improvement Company?

A. They never were.

Since 1912 the stockholders' meetings of the petitioner have been held in the following manner. Every year I have received proxies from the stockholders of record. I have held the meeting in my office, filed the proxies, and have written up the minutes. So
43 far as directors' meetings are concerned, Mr. Widener would come in to see me or ask me to come down to his office and would say, "I want to do so and so"; he would then call in George, his nephew, and later I would write up the minutes and consummate the transaction. There never has been a meeting of either stockholders or directors of the Commonwealth Improvement Company at which the stockholders or directors sat around a table and made motions and passed resolutions in the ordinary sense.

Thereupon counsel for petitioner offered in evidence as petitioner's Exhibit No. 1, copy of the will of P. A. B. Widener, dated July 13, 1912. This was received in evidence over the objection of counsel for the respondent and an exception was granted. No error has been assigned which in any way relates to the contents of the will to the findings made therefrom. Accordingly, petitioner's Exhibit No. 1 is not printed as part of this record.

Thereupon the following colloquy took place between petitioner's counsel and the presiding member of the board:

Mr. ANDREWS. Your honor, you will recall the objection made by Mr. Foley to the offer to show by Mr. Ballard that in 1917 the Commissioner of Internal Revenue had ruled that a paper profit was not a taxable profit. In order that there may be no misunderstanding, I understand your honor's ruling was to the effect that such testimony was not relevant or material and not bearing on Mr. Ballard's competency to testify.

The MEMBER. That is correct.

Mr. Ellis Ames Ballard testified on cross-examination as follows:

44 In stating in my direct examination that the 1920 price of the British-American Tobacco Company stock was identical with the 1913 price, I was not considering the issuance of stock rights and the exercise of those rights. I said "identical," but there may have been a fractional difference; it was practically identical.

The stock of the Commonwealth Improvement Company was not acquired by Mr. Widener for the purpose of having some agency or some medium for holding non-Pennsylvania stocks in order to avoid death duties in case of his death. I presented that phase of the situation to him as his counsel, at the suggestion of his son, George, several months before, but he turned it down. Later on he said that he wanted to create the best security he could as an endowment. If I could do this and make it a lien or a claim against the bulk of his estate, he would do it. That is exactly what happened. He agreed that the property to be transferred to the Commonwealth Improvement Company should be the non-Pennsylvania stocks which he had. At the time of P. A. B. Widener's death Commonwealth Improvement Company held all his non-Pennsylvania stocks except one share of United States Steel preferred, which was simply a qualifying share. As the result of this holding of the non-Pennsylvania stocks, his estate was able to avoid death duties to the States or countries in which these non-Pennsylvania corporations had been incorporated. In Pennsylvania stocks of non-Pennsylvania corporations, in the hands of an individual, are taxed at the rate of four mills, but in the hands of a corporation they are taxed at the rate of five mills, so that from 1912 on the Pennsylvania tax has always been one-fourth greater. That tax was paid to the State to which he owed fealty and not to Oklahoma. I believe that at that time the Oklahoma tax act was so drawn that if an estate

over one and a quarter million dollars was left the tax would exceed 100 per cent.

45 Q. The thing I wanted to bring out, Mr. Ballard, was that the use of the Commonwealth Improvement Company as a medium for holding non-Pennsylvania stocks was productive of the purpose for which it was used, that is, you avoided death duties in other States and countries.

A. As a lawyer I thought this plan up and advised it. My advise was turned down.

Mr. FOLEY. Read the question.

(The pending question was thereupon read by the reporter as above recorded.)

The WITNESS. The answer to that question as you have framed it is no. It was productive for the purpose for which it was used, Mr. Widener's purpose, that he placed as nearly as you can place in Pennsylvania a $4,000,000 lien upon the bulk of his estate, but his purpose was not at any time to avoid these taxes. My own was. That is perfectly true.

Since these non-Pennsylvania stocks were at the time of Mr. Widener's death held by the Commonwealth Improvement Company the estate of P. A. B. Widener paid no estate or inheritance taxes to States other than Pennsylvania on those stocks. At the time of Mr. Widener's death it did not occur to me to contend or to say, rather, to the inheritance tax authorities in these various States that Mr. Widener really owned these non-Pennsylvania stocks, and that the Commonwealth Improvement Company was just a name.

The witness was thereupon excused.

Counsel for petitioner thereupon made the following offer of proof:

Offers in evidence

Mr. ANDREWS. I offer in evidence petitioner's Exhibit No. 2, report of the revenue agent dated June 29, 1921, with respect

46 to the income tax for the year 1919, of the estate of P. A. B. Widener. This report shows that in that year the estate of P. A. B. Widener sustained a loss in transactions between it and the Commonwealth Improvement Company amounting to $167,883.59, and that such loss was denied for the estate of P. A. B. Widener for the reason that the estate of P. A. B. Widener and the Commonwealth Improvement Company were identical, and that a profit made by petitioner for the year 1917 had been held by the commissioner to be a nontaxable profit.

Mr. FOLEY. I object to it on the ground the evidence tendered is irrelevant and immaterial.

The MEMBER. Objection sustained.

Mr. ANDREWS. Exception.

The document offered as petitioner's Exhibit No. 2 consists of seven pages of closely typewritten matter, most of which is not essential to this case. The essential provisions relate to the disallowance of a loss to the estate of P. A. B. Widener in 1919 and the reasons therefor, and are as follows:

"Block C. Original, Form 1041, loss on sale of securities $167,883.59 to the Commonwealth Improvement Company, has been eliminated entirely for the following reason:

"The above-named company acts as a holding company of securities for the P. A. B. Widener estate, the estate owning every share of stock in the corporation.

"The estate and corporation for convenience make a practice of transferring securities to each other.

"In 1917 securities were transferred from the company to the estate at a profit of $131,000, which the trustees objected to being considered as a profit, stating it was simply a transfer.

47 "For details pertaining to this transaction see report of Agents Graves and Mills, dated November 13th, 1918.

"The above agents accepted the explanation given for the 1917 transfer and did not include the $131,000 as taxable income."

Petitioner's counsel thereupon made the following offer of proof:

I offer in evidence, as petitioner's Exhibit No. 3, certificate of overassessment 905088, issued to P. A. B. Widener, second, Joseph E. Widener, George D. Widener, executors and trustees of the estate of P. A. B. Widener, such certificate being for the year 1919, and being offered to show that action proposed in the revenue agent's report offered as petitioner's Exhibit No. 2 was affirmed by the commissioner.

Mr. FOLEY. The same objection.

The MEMBER. Objection sustained and exception noted and allowed.

For the purpose of preserving the record it might be well to mark those for identification petitioner's Exhibits No. 2 and 3. (Said documents so marked.)

The document offered as petitioner's Exhibit No. 3 consists of a printed form used by the Commissioner of Internal Revenue entitled "Certificate of overassessment," for the purpose of showing his final disposition of overassessments determined in the examination of income tax returns of a taxpayer. The document contains the following language:

"The report of the revenue agent in Philadelphia, Pennsylvania, dated June 29, 1921, has been reviewed and approved."

The certificate of overassessment further discloses the fact that
48 the overassessment which had been approved by the Commissioner of Internal Revenue was allowed as a credit in settlement of other outstanding tax liabilities.

Counsel for petitioner and counsel for respondent stipulated that the cost of 225,000 shares of British-American Tobacco Company

stock to Commonwealth Improvement Company in 1912 was $3,966,002.

The foregoing evidence is all the material evidence adduced at the hearing and the same is approved by the undersigned as attorney for Commonwealth Improvement Company.

(Sgd.) WM. R. SPOFFORD.

The above statement of the evidence is agreed to by C. M. Charest, general counsel, Bureau of Internal Revenue, as attorney for the Commissioner of Internal Revenue.

(Sgd.) C. M. CHAREST,
General Counsel, Bureau of Internal Revenue.

49 Before U. S. Board of Tax Appeals

Præcipe for record

Filed May 6, 1931

To the clerk of the United States Board of Tax Appeals:

You will please prepare and, within sixty days or within such time as extended by order of the board from the date of the filing of the petition for review in the above-stated cause, transmit to the clerk of the United States Circuit Court of Appeals for the Third Circuit certified copies of the following documents:

1. The docket entries of proceedings before the United States Board of Tax Appeals in the above-entitled case.
2. All pleadings before the board.
3. Findings of fact, opinion, and decision of the board and its order of redetermination, dated October 9, 1930.
4. Petition for review.
5. Statement of the evidence settled or agreed upon.

The certified copies of the foregoing documents are to be prepared and transmitted as required by law and the rules of the United States Circuit Court of Appeals for the Third Circuit.

Dated this sixth day of May, 1931.

(Sgd.) WM. R. SPOFFORD,
Attorney for Petitioner on Review.

50 [Clerk's certificate to foregoing transcript omitted in printing.]

51 In United States Circuit Court of Appeals for the Third Circuit

No. 4639 (List No. 27). October term, 1931

COMMONWEALTH IMPROVEMENT CO., PETITIONER

vs.

COMMISSIONER OF INTERNAL REVENUE, RESPONDENT

Appeal from the U. S. Board of Tax Appeals

Order assigning judges

Filed Oct. 16, 1931

And now, to wit, this sixteenth day of October, A. D. 1931, it is ordered that Hon. Albert W. Johnson, district judge, for the Middle District of Pennsylvania, and Hon. ———, district judge for the ——— District of ———, be, and he is hereby assigned to sit in above case in order to make a full court.

VICTOR B. WOOLLEY,
Circuit Judge.

[File endorsement omitted.]
[Minute entry of argument and submission, Oct. 16, 1931, omitted in printing.]

52 In United States Circuit Court of Appeals for the Third Circuit

No. 4639. October term, 1931

COMMONWEALTH IMPROVEMENT COMPANY, PETITIONER

v.

COMMISSIONER OF INTERNAL REVENUE, RESPONDENT

Petition for review from the United States Board of Tax Appeals

Opinion

Filed March 17, 1932

Before WOOLLEY and DAVIS, Circuit Judges, and JOHNSON, District Judge

DAVIS, Circuit Judge.

This petition for review concerns income and excess profits taxes for the year 1920. The extraordinary situation here arises out of the relation of the taxpayer to the estate of P. A. B. Widener.

In 1912, Mr. Widener, desiring to place a lien on his fortune to insure an endowment to the Widener Memorial School for Crippled Children, which was his favored charity, transferred all of his stocks and securities, except those of Pennsylvania corporations, to the taxpayer, Commonwealth Improvement Company, a Pennsylvania corporation, whose charter he had purchased for this purpose. In return, the taxpayer issued and transferred to Mr. Widener all of its stock and bonds, aggregating a par value of $25,000,000.

Mr. Widener executed a deed of trust, and delivered to the trustee $4,000,000 of the taxpayer's bonds to be held as a perpetual endowment for the charity. Mr. Widener died three years thereafter, and as a consequence of the situation, whereby the taxpayer held all of his stocks and securities save those of Pennsylvania companies, the estate paid no death taxes to any State other than Pennsylvania.

After Mr. Widener's death the capital structure of the taxpayer was reduced to $2,000,000 in stock, and $4,000,000 of debentures, the latter being the same deposited with the trustee for the charity. The remainder of the stock and bonds was canceled and destroyed. The reduction of the capital structure was effected by transferring from the taxpayer to the trustee of the Widener estate securities equal in value to the stock and bonds canceled, any difference in value being entered on the books of each.

Among the stocks transferred to the taxpayer in 1912 were 225,000 shares of the British-American Tobacco Company, having on March 1, 1913, a value of $5,315,625, or $23.625 per share. In 1919 the British-American Tobacco Company gave the privilege to subscribe to one share of new stock at $4.3525 for every three shares
53 held by a stockholder. The taxpayer taking full advantage of its right, purchased 75,000 shares for $326,437.50.

In 1920 it was deemed advisable to substitute certain real estate bonds of the Widener estate for the $4,000,000 of debentures of the taxpayer which were held in trust for the charity. By this transaction, the estate again became the owner of the remaining outstanding debentures of the taxpayer.

And thus came about the unusual situation which brings us to the issue in this case. The trustees of the Widener estate owned the entire interest in the taxpayer, and completely dominated it. The following transaction was arranged: The taxpayer transferred 225,000 shares of the stock of the British-American Tobacco Company to the trustees of the estate in consideration of the estate surrendering the $4,000,000 of debenture bonds of the taxpayer (being the same bonds formerly held by the trustee for charity) and certain other transactions totaling $1,287,500. Hence the 225,000 shares of the British-American Tobacco Company were exchanged for $5,287,500, or $23.50 per share.

In its income-tax return for 1920 the taxpayer claimed as a loss the difference between the March 1, 1913, value of $5,315,625 for 225,000 shares and the amount of $5,287,500 realized by the exchange

with the Widener estate. But the Commissioner of Internal Revenue made the following adjustment in the March 1, 1913, value:

225,000 shares; March 1, 1913, value	$5, 315, 625. 00
75,000 shares; acquired on exercise of stock rights for	326, 437. 50
300,000 shares	5, 642, 062. 50
1 share	18. 803875
225,000 shares	4, 231, 566. 88

According to the determination of the commissioner, the exchange resulted in a profit of $1,055,953.12 instead of the loss claimed by the taxpayer, and a deficiency in income tax for 1920 of $294,388.42. The Board of Tax Appeals sustained the commissioner's decision. 20 B. T. A. 1189.

Section 213 (a) of the revenue act of 1918 provides that gross income includes gains, profits, and income derived from dealings in property. Here there has been an exchange of property resulting apparently in a large profit which would obviously be taxable. Section 202 (d) of the revenue act of 1918.

The taxpayer itself concedes that it and the estate are distinct beings in contemplation of the law and subject to the burdens thereof. But the taxpayer asks this court to deny the Government's right to tax gains, profits, or income that are illusory, and do not exist in fact.

By determining whether this court has the power to examine this exchange of property for its substance, we come to the ultimate questions in this case: (a) Is there any real gain or loss to be taxed? and (b) did Congress intend to tax that which is income in form only?

Counsel for the taxpayer have offered two cases, which they frankly admit do not control this case on its facts, to show that we may
54 examine the transaction here concerned for its substance as an incidence to income taxation. Southern Pacific Company v. Lowe, 247 U. S. 330; Gulf Oil Corporation v. Lewellyn, 248 U. S. 71.

In the Southern Pacific Company case, the plaintiff railway company owned all the stock of, and leased, a second railroad. The property and funds of the subsidiary company were in the possession of the plaintiff. In 1913 the plaintiff caused the subsidiary to declare a dividend on income accumulated prior to 1913, payment of which was effected by a credit to the plaintiff on its books. The Supreme Court held that the dividend was not subject to an income tax, as the income out of which it had been declared, although earnings accumulated prior to the effective date of the sixteenth amendment were taxable, under the peculiar facts of the case, had substantially accrued to the plaintiff before the declaration of the dividend. The principle of the case was extended to Gulf Oil Company v. Lewellyn, supra, wherein the holding corporation which received the dividend was the owner of all the stock of a subsidiary and engaged in a single enterprise, but was not the lessee and neither conducted the business nor was in possession of the funds of the subsidiary.

The point comes down to this: Did Congress intend that "income" should be used as a word of art or in a real and practical sense? In the Southern Pacific case, the Supreme Court said:

"We base our conclusion in the present case upon the view that it was the purpose and intent of Congress, while taxing 'the entire net income arising or accruing from all sources' during each year commencing with the first day of March, 1913, to refrain from taxing that which, in mere form only, bore the appearance of income accruing after that date, while in truth and in substance it accrued before; and upon the fact that the Central Pacific and the Southern Pacific were in substance identical because of the complete ownership and control which the latter possessed over the former, as stockholder and in other capacities."

The principle announced in those two cases of the Supreme Court controls this case. This court will examine the exchange of property between the taxpayer and the Widener estate to determine if it in fact produced income.

At the time of the exchange the regulations of the Treasury Department prescribed the value of March 1, 1913, of stock acquired prior to that time as the basis for determining profit or loss. Article 39, Regulations 45. But the regulations were amended in 1922 by T. D. 3206, and accordingly the commissioner ruled that the value of the stock must be reduced proportionally by the quotient basis because the taxpayer had acquired 75,000 additional shares in 1919 by virtue of its stock rights. On paper, then, the commissioner determined that the taxpayer had made a large profit by the exchange.

55 The trustees of the Widener estate completely dominated the taxpayer. They owned and controlled it. The purpose, whatever it may have been, for the purchase of the taxpayer, had been served. In 1920 there seemed no longer to be any need for its existence, and so the trustees were evidently proceeding to wind up its affairs in an orderly fashion. Without question the transaction might have taken any form that the trustees desired.

No cash was exchanged for the stock. The taxpayer's assets had been materially reduced, and it was considered sound by the trustees to substitute other securities for the bonds of the taxpayer held by the Charity. Thus the estate obtained the bonds from the Charity, and to reduce further the taxpayer's capital structure the bonds were surrendered by the estate to the taxpayer and cancelled. Obviously, in actual dollars and cents, it made no difference to the estate itself whether or not they obtained anything in return; but in order to balance the books the block of British-American Tobacco stock was taken, as its then value was substantially the same as on March 1, 1913, and was the largest single block standing in the taxpayer's name.

The stock was transferred, and to offset the balance due the taxpayer on the exchange it was given credit on its books. The result

of the transaction produced no gain, nor loss, nor income to either the taxpayer or the Widener estate.

The Board of Tax Appeals was of the opinion that "the form which the transaction took truly represents the transaction which took place," that is, that the taxpayer actually received a profit of $1,055,953.12. But in this the board is mistaken. The profit resulting to the taxpayer is illusory and nonexistent. The law is interested in an income from which an economic benefit may be realized. The exchange resulted in a mere paper profit, and this was made possible only because the regulations were changed some two years after the transaction.

The estate owned the taxpayer, and was in control and possession of all of its property. In substance, the taxpayer in this case was a mere agent of the Widener estate, and did not realize any taxable profit from this transaction, and so the order of redetermination of the Board of Tax Appeals is reversed.

A true copy.

Teste:

Clerk of the United States Circuit Court of Appeals for the Third Circuit.

56 In United States Circuit Court of Appeals for the Third Circuit

No. 4639. October term, 1931

COMMONWEALTH IMPROVEMENT CO., PETITIONER

v.

COMMISSIONER OF INTERNAL REVENUE, RESPONDENT

Appeal from the United States Board of Tax Appeals

Judgment

Filed March 17, 1932

This cause came on to be heard on the transcript of record from the United States Board of Tax Appeals, and was argued by counsel.

On consideration whereof, it is now here ordered, adjudged, and decreed by this court that the order or decree of the said Board of Tax Appeals in this cause be, and the same is hereby, reversed.

Philadelphia, March 17, 1932.

J. WARREN DAVIS,
Circuit Judge.

[File indorsement omitted.]

[Clerk's certificate to foregoing transcript omitted in printing.]

57 Supreme Court of the United States

Order allowing certiorari

Filed May 31, 1932

The petition herein for a writ of certiorari to the United States Circuit Court of Appeals for the Third Circuit is granted, and the case is assigned for argument immediately following case No. 911, Dalton vs. Bowers, as executor.

And it is further ordered that the duly certified copy of the transcript of the proceedings below which accompanied the petition shall be treated as though filed in response to such writ.

(Indorsement on cover:) File No. 36791. U. S. Circuit Court of Appeals, Third Circuit. Term No. 95. David Burnet, Commissioner of Internal Revenue, petitioner, vs. Commonwealth Improvement Company. Petition for a writ of certiorari and exhibit thereto. Filed May 20, 1932. File No. 36791.

U. S. GOVERNMENT PRINTING OFFICE: 1932

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In the Supreme Court of the United States

OCTOBER TERM, 1931.

DAVID BURNET, COMMISSIONER OF INTERNAL REVENUE, PETITIONER

v.

COMMONWEALTH IMPROVEMENT COMPANY

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE THIRD CIRCUIT AND BRIEF IN SUPPORT THEREOF

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In the Supreme Court of the United States

OCTOBER TERM, 1931

No. ——

DAVID BURNET, COMMISSIONER OF INTERNAL REVENUE, petitioner

v.

COMMONWEALTH IMPROVEMENT COMPANY

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE THIRD CIRCUIT AND BRIEF IN SUPPORT THEREOF

PETITION

The Solicitor General, on behalf of the Commissioner of Internal Revenue, prays that a writ of certiorari issue to review the judgment of the United States Circuit Court of Appeals for the Third Circuit entered in the above cause on March 17, 1932, reversing the decision of the United States Board of Tax Appeals.

STATEMENT

The findings of fact by the Board of Tax Appeals (R. 16–20), so far as relevant, are as follows:

In 1912 P. A. B. Widener transferred all his
curities, except those of Pennsylvania corp
tions,[1] to the taxpayer, a Pennsylvania corporat
in return for which the taxpayer issued to Wide
$25,000,000 worth of its stocks and bonds which
stituted all of the securities issued by it. Wide
died in 1915, and as a result of the transfer of
securities to the taxpayer, no death taxes were p
to any States except Pennsylvania. (R. 16–
Widener's executors and trustees constituted
of the taxpayer's three directors, the third was
counsel, later counsel for his estate. (R. 18.)
trustees received salaries as officers of the taxpa
but no commissions as trustees. (R. 19.) The
fice expenses of the estate were paid by the t
payer. (R. 19.)

Among the securities transferred by Widene
the taxpayer in 1912 were 225,000 shares of Briti
American Tobacco Company stock, the value
which on March 1, 1913, was $5,315,625, or $23.
per share. In 1919 taxpayer acquired the righ
subscribe for one new share of this stock for ev
three shares it held at a price of $4.3525 per sh
and exercised the right by purchasing 75,000 sha
for $326,437.50. (R. 20.)

In 1920 the taxpayer transferred to the Wide
estate 225,000 shares of this stock of a market va
of $23.50 per share or a total of $5,287,500, in ret
for which it received certain stocks and bonds
credits to its account. (R. 20.) In its return

[1] And one share of United States Steel Corporation st

1920, the taxpayer showed a loss by applying the selling price of $5,287,500 against $5,315,625, representing the March 1, 1913, value. (R. 10, 21.)

The Commissioner made the following adjustment in the March 1, 1913, value. He added the March 1, 1913, value of the original 225,000 shares in the sum of $5,315,625 to the cost of the acquisition of the 75,000 shares in the sum of $326,437.50, making a total of $5,642,062.50 for 300,000 shares. He divided $5,642,062.50 by 300,000, which gives a price of $18.806875 for 1 share; and multiplied the price of one share by 225,000, resulting in an adjusted value in the sum of $4,231,566.88 for 225,000 shares. (R. 10–12.)

This resulted in a profit of $1,055,953.12 instead of the loss claimed by the taxpayer, and the determination by the Commissioner of a deficiency in tax of $294,388.42. (R. 10–12.) The taxpayer filed a petition for review of the Commissioner's determination with the Board of Tax Appeals (R. 3), which upheld the Commissioner's action. (20 B. T. A. 1189.)

The taxpayer appealed to the Circuit Court of Appeals for the Third Circuit (R. 26), which reversed the decision of the Board of Tax Appeals, holding that the estate owned the taxpayer and that under the circumstances the profit determined by the Commissioner was illusory and nonexistent. Holding thus that the separate identities of the corporation and the estate should be disregarded, the court below found it unnecessary to

pass expressly upon the question of the validity of Article 39, as amended, of Treasury Regulations 45, which was also presented to it.

SPECIFICATION OF ERRORS TO BE URGED

1. The Circuit Court of Appeals erred in deciding that the taxpayer, a corporation, and the Widener estate, which owned all the stock of the corporation, were in substance identical, so that a transaction between them could not result in gain or loss under Section 202 of the Revenue Act of 1918.

2. The Circuit Court of Appeals erred in not deciding that there was a deficiency in the amount of $294,388.42 in the respondent's income and profits taxes for the year 1920.

3. The Circuit Court of Appeals erred in reversing the judgment of the Board of Tax Appeals.

REASONS FOR GRANTING THE WRIT

1. The decision of the Circuit Court of Appeals in holding that where an estate owns all the stock of a corporation, the separate entity of the corporation should be disregarded for Federal tax purposes, is in conflict in principle with the following decisions of the Circuit Court of Appeals for the Second Circuit, the Court of Appeals of the District of Columbia, and the Circuit Court of Appeals for the Fifth Circuit: *Nixon* v. *Lucas,* 42 F. (2d) 833 (C. C. A. 2d); *Wagner* v. *Lucas,* 38 F. (2d) 391 (App. D. C.); *Goldberg* v. *Commissioner,* 36 F. (2d) 551 (App. D. C.); *Planters' Cotton Oil Co., Inc.,* v. *Hopkins,* 53 F. (3d) 285 (C. C.

A. 5th), affirmed as No. 672, October Term, 1931, on May 16, 1932.

2. Because of the number of corporations all of whose stock is owned by an individual or an estate or a partnership or by some other taxable entity other than a corporation, the question as to whether or not transactions between two such entities result in taxable gain or deductible loss frequently arises in various forms under all the Revenue Acts. This question is of general importance in administering the income tax laws. The court below regarded the decisions of this Court in *Southern Pacific Company* v. *Lowe*, 247 U. S. 330, and *Gulf Oil Corporation* v. *Lewellyn*, 248 U. S. 71, as laying down principles of general application in tax cases. The court in *Nixon* v. *Lucas, supra*, concluded that the *Southern Pacific Co.* case had a more limited application. It is of importance to the Government and to taxpayers generally that the question presented in this case should be settled by this Court so that existing confusion may be removed.

Wherefore, it is respectfully submitted that the petition should be granted.

THOMAS D. THACHER,
Solicitor General.

MAY, 1932.

BRIEF IN SUPPORT OF THE PETITION

OPINIONS BELOW

The opinion of the Board of Tax Appeals (R. 16–25) is reported in 20 B. T. A. 1189. The opinion of the Circuit Court of Appeals is not yet reported.

JURISDICTION

The judgment of the Circuit Court of Appeals for the Third Circuit was entered March 17, 1932. The jurisdiction of this Court is invoked under Section 240 (a) of the Judicial Code as amended by the Act of February 13, 1925.

QUESTION PRESENTED

Whether in this case the corporation and the estate, which owns all the stock of the corporation, are separate entities, so that a transaction between them resulted in gain under Section 202 of the Revenue Act of 1918.

STATUTE INVOLVED

Revenue Act of 1918, c. 18, 40 Stat. 1057, 1060, 1065, 1077:

> SEC. 202. (a) That for the purpose of ascertaining the gain derived or loss sustained from the sale or other disposition of property, real, personal, or mixed, the basis shall be—

(1) In the case of property acquired before March 1, 1913, the fair market price or value of such property as of that date; * * *

* * * * *

(b) When property is exchanged for other property, the property received in exchange shall for the purpose of determining gain or loss be treated as the equivalent of cash to the amount of its fair market value, if any; * * *.

SEC. 213. That for the purposes of this title * * * the term "gross income"—

(a) Includes gains, profits, and income derived from * * * dealings in property, whether real or personal, growing out of the ownership or use of or interest in such property; also from interest, rent, dividends, securities, or the transaction of any business carried on for gain or profit, or gains or profits and income derived from any source whatever. * * *

SEC. 233. (a) That in the case of a corporation subject to the tax imposed by section 230 the term "gross income" means the gross income as defined in section 213, * * *.

STATEMENT

A statement of the facts and the errors to be relied upon will be found in the petition.

ARGUMENT

In concluding that the separate entities of the corporation and the estate which controlled it

should be disregarded in this case, the court below relied chiefly upon two decisions of this Court, *Southern Pacific Co.* v. *Lowe,* 247 U. S. 330, and *Gulf Oil Corp.* v. *Lewellyn,* 248 U. S. 71, which it apparently considered as laying down a principle of universal application in tax cases. In those cases, this Court decided that where one corporation owned all the stock of another and controlled its management, and dividends were declared by the subsidiary out of earnings that accrued before the adoption of the Sixteenth Amendment, the distributions were capital and not income. In the *Southern Pacific Co.* case, this Court said (p. 338):

> The case turns upon its very peculiar facts, and is distinguishable from others in which the question of the identity of a controlling stockholder with his corporation has been raised.

In *Nixon* v. *Lucas,* 42 F. (2d) 833 (C. C. A. 2d), which is one of the cases now relied upon as in conflict with the decision of the court below, the court declined to regard the *Southern Pacific Co.* case as laying down a general rule of universal application in tax cases and treated it as depending upon its peculiar facts.

We believe that the decisions of this Court relied on by the court below do not govern this case. In the instant case, the gain in question accrued long after the adoption of the Sixteenth Amendment, and two kinds of taxable entities, carrying different rates of taxation—an estate and a corporation—

were involved. Congress recognized the principle of the substantial identity of two corporations, one of which owned all the stock of the other, by enacting Section 240 of the Revenue Act of 1918 and successive provisions in later Acts, which permitted two or more corporations to file a consolidated return under prescribed circumstances. But Congress gave no corresponding privilege to an estate or an individual which owned all the stock of a corporation. The Court of Appeals of the District of Columbia, the Circuit Court of Appeals for the Second Circuit, and the Circuit Court of Appeals for the Fifth Circuit have decided that under circumstances analogous to those in the instant case, the corporate entity should not be disregarded.

In *Goldberg* v. *Commissioner,* 36 F. (2d) 551 (App. D. C.), wherein a taxpayer sought to identify himself with the corporation of which he was the sole stockholder, the court said (p. 552):

> While it is true that this was a one-man corporation, of which appellant owned the entire stock, it nevertheless was a separate and distinct corporate entity, and the business transacted in the name of the corporation was not the business of appellant but the business of the corporation, and as such entirely separate and distinct from the private affairs of appellant.

In *Wagner* v. *Lucas,* 38 F. (2d) 391 (App. D. C.), the court refused to recognize the identity of an individual and a corporation of which he owned practically all the stock, and said (p. 392):

> It is true that the court, in tax cases as well as in other matters, where a corporation is a one-man corporation, may look through the corporate entity, and, where necessary to accomplish the ends of justice or prevent fraud, attach responsibility to the individual. We think, however, that there is no occasion for the application of this rule in the present case. * * * The mere fact that he owned substantially all of the stock in the Washington corporation would not deprive it of functioning as a corporate entity. It possessed all the powers and liabilities of a private corporation, and must be treated as such.

In *Nixon* v. *Lucas,* 42 F. (2d) 833 (C. C. A. 2d), three partners, who were engaged in selling lumber, owned all of the stock in a company from which they purchased lumber, and asserted the right to deduct in their individual returns a loss suffered by the company. The Court said (p. 834):

> In the case at bar the partners chose, for some reason not disclosed, to deal with the company as a legal person, which they could do if they wished. Their agreements created contracts with the same obligations as though the company had been an individual. There were no attendant circumstances which show that they were not so intended, as in the case of contracts made as a jest, or only to serve as a blind. The fact that the partners could at any time have taken over the assets and dealt directly with their customers, is not a reason for looking behind the pattern

so devised and used. Whatever they might have done, they did what they did.

In *Planters' Cotton Oil Co., Inc.*, v. *Hopkins*, 53 F. (2d) 825 (C. C. A. 5th), certiorari granted March 21, 1932, affirmed as No. 672, October Term, 1931, on May 16, 1932, the Circuit Court of Appeals declined to regard one who owned substantially all the stock in several corporations as so identified with them that "net losses" sustained by two of the companies could be treated as if they had been the "net losses" of the stockholder or of other corporations which he controlled.

It may be pointed out that the taxpayer held itself out as a separate entity when it claimed a loss on the identical transaction which the Commissioner determined resulted in a gain. (R. 10, 21.) Moreover, during Widener's life and after his death, taxpayer paid taxes at the rates governing corporations instead of individuals or estates, and the transfer by Widener of his non-Pennsylvania stocks to the taxpayer resulted in the avoidance of estate taxes outside of Pennsylvania. (R. 18.) Having chosen to create a separate entity and having received the benefits inherent in enterprises conducted in corporate form, the management of the taxpayer should not now be allowed to deny its separate character merely because it would be to its present advantage to do so.

The decision of the court below disregarding the corporate entity rendered it unnecessary to decide the question of ascertaining the basis for determin-

ing gain or loss where a stockholder exercises the right to subscribe to new stock of substantially the same character, and the court did not expressly pass upon the question. However, the court said in its opinion:

> At the time of the exchange, the regulations of the Treasury Department prescribed the value of March 1, 1913, of stock acquired prior to that time as the basis for determining profit or loss. Article 39, Regulations 45. But the regulations were amended in 1922 by T. D. 3206, and accordingly the Commissioner ruled that the value of the stock must be reduced proportionally by the quotient basis because the taxpayer had acquired 75,000 additional shares in 1919 by virtue of its stock rights. On paper, then, the Commissioner determined that the taxpayer had made a large profit by the exchange.

The occasion for the change in the regulations was the decision of this Court in *Miles* v. *Safe Deposit Co.*, 259 U. S. 247. The Commissioner amended the regulations so that they would conform to the principles laid down by this Court. If the court below intended to question the validity of the regulations as amended, the decision is in conflict with that of the Court of Appeals of the District of Columbia in *Ayer* v. *Blair*, 25 F. (2d) 534, which held under similar circumstances that the cost of the old and of the new stock must be averaged in order to determine the basis upon which gain or loss should be determined.

CONCLUSION

The decision of the court below appears to be wrong, and it is in conflict in principle with the decisions of other Circuit Courts of Appeals. Moreover, the question involved is of general importance in the administration of the tax laws, and it is desirable that it should be authoritatively settled by a decision of this Court to eliminate existing conflicts of decisions and so that the apparent confusion as to the proper application of its decision in the *Southern Pacific Co.* case may be removed. Therefore, it is respectfully submitted that the petition for certiorari in this case should be granted.

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MAY, 1932.

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No. 95

In the Supreme Court of the United States

OCTOBER TERM, 1932

DAVID BURNET, COMMISSIONER OF INTERNAL REVENUE, PETITIONER

v.

COMMONWEALTH IMPROVEMENT COMPANY

ON WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE THIRD CIRCUIT

BRIEF FOR THE PETITIONER

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In the Supreme Court of the United States

OCTOBER TERM, 1932

No. 95

DAVID BURNET, COMMISSIONER OF INTERNAL REVENUE, petitioner

v.

COMMONWEALTH IMPROVEMENT COMPANY

ON WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE THIRD CIRCUIT

BRIEF FOR THE PETITIONER

OPINIONS BELOW

The opinion of the Board of Tax Appeals (R. 11–14) is reported in 20 B. T. A. 1189. The opinion of the Circuit Court of Appeals for the Third Circuit (R. 29–33) is reported in 57 F. (2d) 47.

JURISDICTION

The judgment of the Circuit Court of Appeals was entered March 17, 1932. (R. 33.) The petition for certiorari was filed May 20, 1932, and was

granted May 31, 1932. Jurisdiction is conferred upon this Court by Section 240 (a) of the Judicial Code as amended by the Act of February 13, 1925.

QUESTIONS PRESENTED

1. Whether a corporation may derive taxable income upon an exchange of securities with its sole stockholder if, as between other parties, income would be derived.

2. Where a stockholder exercises the right to subscribe to new stock of substantially the same character as the stock with respect to which the right is issued, should the average cost of the old and new shares be used as the basis for determining gain or loss upon the sale or other disposition of the original shares, as provided by Article 39 of Treasury Regulations 45 as amended?

STATUTE AND REGULATIONS INVOLVED

Revenue Act of 1918, c. 18, 40 Stat. 1057, 1060.

> SEC. 202. (a) That for the purpose of ascertaining the gain derived or loss sustained from the sale or other disposition of property, real, personal, or mixed, the basis shall be—
>
> (1) In the case of property acquired before March 1, 1913, the fair market price or value of such property as of that date; and
>
> (2) In the case of property acquired on or after that date, the cost thereof; or the inventory value, if the inventory is made in accordance with section 203.

(b) When property is exchanged for other property, the property received in exchange shall for the purpose of determining gain or loss be treated as the equivalent of cash to the amount of its fair market value, if any; * * *.

Article 39 of Treasury Regulations 45 (1920 Edition), as amended by Treasury Decision 3402, I–2 C. B. 63, promulgated October 18, 1922:

ART. 39. *Sale of stock and rights.*—* * * Where a corporation issues to its stockholders the right to subscribe to its stock, the value of the right does not constitute taxable income to the stockholder, but gain may be derived or loss sustained by the stockholder from the sale of such right. * * *:

* * * Where the stockholder exercises his right to subscribe to new stock of substantially the same character or preference as the stock with respect to which the right is issued, the cost of the old and new shares (or, if acquired prior to March 1, 1913, the fair market value as of that date) will be the quotient of the cost of the old shares, plus the subscription price of the new shares, divided by the total number of the old and new shares. * * *

STATEMENT

The Circuit Court of Appeals for the Third Circuit (R. 33) reversed a decision of the Board of Tax Appeals determining a deficiency of $294,388.42 for the year 1920 (R. 14) upon the following facts:

In 1912, P. A. B. Widener, a resident of Pennsylvania, transferred all his securities, except those of Pennsylvania corporations and one share of United States Steel Corporation stock, to the respondent, a Pennsylvania corporation, in return for all of respondent's stocks and bonds, aggregating $25,000,000 par value. (R. 9.[1])

Widener died testate in 1915. (R. 10.) Thereafter, respondent's officers and three directors were Widener's two executors and trustees,[2] and the attorney for his estate. The trustees received salaries as officers of the taxpayer, but no commissions as trustees. The office expenses of the estate were paid by the respondent. (R. 10.)

Among the securities transferred by Widener to the respondent in 1912 were 225,000 shares of British-American Tobacco Company stock, the value of which on March 1, 1913, was $5,315,625, or $23.625 per share. (R. 11.)

---

[1] At the time of this transaction it was supposed that corporate stocks and bonds of a decedent were subject to estate taxes of the State of the decedent's domicile as well as the State of the domicile of the corporation. See *Blackstone* v. *Miller*, 188 U. S. 189, overruled January 6, 1930, in *Farmers Loan Co.* v. *Minnesota*, 280 U. S. 204. Cf. *Baldwin* v. *Missouri*, 281 U. S. 586; *First National Bank* v. *Maine*, 284 U. S. 312.

While the sole witness for respondent denied that this transfer was made for the purpose of avoiding such double taxation in event of Widener's death (R. 25), the record strongly indicates that such was its purpose (R. 9–10, 20, 30), and this witness thought that the plan had resulted in this saving (R. 25).

[2] Widener's son and a grandson. (R. 10.)

In 1919 the respondent acquired the right to subscribe for one new share of this stock for every three shares it held, at a price of $4.3525 per share, and exercised such right by purchasing 75,000 shares for $326,437.50. (R. 3, 11.)

In 1920 respondent transferred to the Widener Estate, the certificates representing the original 225,000 shares of this stock of a then market value of $23.50 a share, or a total of $5,287,500, in return for which it received certain stocks and bonds and credits to its account of equal value. (R. 2, 11, 22–24.)

In its return for 1920 the respondent claimed a deduction for a loss computed by applying the selling price of $5,287,500 against $5,315,625, the March 1, 1913, value of the 225,000 shares. (R. 5, 12.)

The Commissioner of Internal Revenue disallowed the loss, and in accordance with Article 39 of Treasury Regulations 45, as amended by T. D. 3402, determined a gain by adding the March 1, 1913, value of the 225,000 shares ($5,315,625) to the cost of the 75,000 additional shares ($326,437.50) and dividing the total ($5,642,062.50) by the total number of shares (300,000). This gave an average cost base of $18.806875 per share, or a cost base of $4,231,546.88 for the 225,000 shares, which was $1,055,953.12 less than the value of the stocks, bonds, and credits received in exchange. Upon this difference the Commissioner determined a deficiency in tax of $294,388.42. (R. 5–7, 12, 14.)

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Upon petition for review the Board of Tax Appeals sustained the action of the Commissioner. (R. 14.) The Circuit Court of Appeals for the Third Circuit reversed, holding that since the estate owned all of the stock of the respondent the profit determined by the Commissioner was illusory and nonexistent. (R. 29–33.) Reaching that conclusion it became unnecessary for the court to determine the validity of Article 39, as amended, of Treasury Regulations 45, which is embraced in the second question stated, *infra*. This Court granted certiorari.

SPECIFICATION OF ERRORS TO BE URGED

The Circuit Court of Appeals erred:

1. In deciding that the taxpayer, a corporation, and the Widener estate, which owned all the stock of the corporation, were in substance identical, so that a transaction between them could not result in gain or loss under Section 202 of the Revenue Act of 1918.

2. In not deciding that there was a deficiency in the amount of $294,388.42 in respondent's income and profits taxes for the year 1920.

3. In reversing the judgment of the Board of Tax Appeals.

SUMMARY OF ARGUMENT

A corporation and its stockholders are separate entities; and it is of no importance that all of the corporate stock is held by a single person. Con-

gress has observed this distinction in each of the Revenue Acts enacted under the Sixteenth Amendment by taxing corporations and individuals separately and including dividends in the gross income of both. When Congress desired to have the distinction between a corporation and its sole stockholder disregarded, it made specific provision therefor by authorizing the filing of a consolidated return. The decision of the court below is contrary to decisions of this Court and the weight of authority in the other Federal courts.

The decisions of this Court in *Southern Pacific Co.* v. *Lowe,* 247 U. S. 330, and *Gulf Oil Corporation* v. *Lewellyn,* 248 U. S. 71, are distinguishable and do not control decision here.

If this Court reverses the decision of the court below, the computation of the tax as made by the Commissioner and approved by the Board of Tax Appeals should be affirmed.

ARGUMENT

I

THE RESPONDENT AND ITS SOLE STOCKHOLDER WERE SEPARATE TAXABLE ENTITIES, AND THEREFORE THE TRANSACTION INVOLVED RESULTED IN TAXABLE GAIN

The court below held that since the Widener estate "owned and controlled" the respondent (R. 32) the transfer of the assets of the corporation to the estate in exchange for its bonds and other property did not result in any taxable profit (R.

33). It considered that it was required to examine the substance of the transaction, and that when so considered the result of the exchange was a mere paper profit which it regarded as "illusory and nonexistent." (R. 33.)

In its brief in opposition the respondent urged that it was not necessary to disregard the separate corporate entity of respondent in order to reach the conclusion that the gain taxed was illusory and that the decision of the court below was based upon the peculiar facts of this case. If the same transaction had occurred between respondent and an individual or a corporation which did not own respondent's stock any resulting gain would have been clearly taxable. The contention that such gains are not taxable requires that the respondent and its sole stockholder be considered as one and the same person, having, in transactions *inter sese,* no separate identity in the eyes of the law.

The fundamental question presented is whether, if a transaction would otherwise result in taxable gain under the Revenue Acts, such gain must be disregarded where the transaction is between a corporation and its sole stockholder.

It is settled by many decisions of this Court that a corporation and its stockholders are separate entities. *Klein* v. *Board of Tax Supervisors,* 282 U. S. 19, 23–24; *Cannon Manufacturing Co.* v. *Cudahy Packing Co.,* 267 U. S. 333; *People's Tobacco Co.* v. *American Tobacco Co.,* 246 U. S. 79;

Donnell v. *Herring-Hall-Marvin Safe Co.*, 208 U. S. 267, 273; *Peterson* v. *Chicago, Rock Island & Pacific Ry.*, 205 U. S. 364, 392. In the *Klein* case, *supra*, this Court said (at p. 24):

> But it leads nowhere to call a corporation a fiction. If it is a fiction it is a fiction created by law with intent that it should be acted on as if true. The corporation is a person and its ownership is a nonconductor that makes it impossible to attribute an interest in its property to its members. *Donnell* v. *Herring-Hall-Marvin Safe Co.*, 208 U. S. 267, 273. * * *

In the *Donnell* case, *supra*, this Court said (at p. 273):

> Philosophy may have gained by the attempts in recent years to look through the fiction to the fact and to generalize corporations, partnerships and other groups into a single conception. But to generalize is to omit, and in this instance to omit one characteristic of the complete corporation, as called into being under modern statutes, that is most important in business and law. A leading purpose of such statutes and of those who act under them is to interpose a nonconductor, through which in matters of contract it is impossible to see the men behind. * * *

The fact that all of the corporate stock is owned by a single stockholder does not change the rule. *Planters' Cotton Oil Co.* v. *Hopkins*, 286 U. S. 332;

Cannon Manufacturing Co. v. *Cudahy Packing Co., supra,* 267 U. S. 333, 335, 337; *Conley* v. *Mathieson Alkali Works,* 190 U. S. 406, 408, 411–412; *American Cyanamid Co.* v. *Wilson & Toomer Fertilizer Co.,* 51 F. (2d) 665, 670 (C. C. A. 5th); *Texas Co. of Mexico, S. A.* v. *Roos,* 43 F. (2d) 1, 15 (C. C. A. 5th), certiorari denied, 282 U. S. 902; *Wagner* v. *Lucas,* 38 F. (2d) 391, 392 (App. D. C.); *Goldberg* v. *Commissioner,* 36 F. (2d) 551, 552 (App. D. C.).

It seems unnecessary to discuss the cases where the separate character of the corporate entity is relied on to cloak a fraud, or protect individuals from punishment for a violation of law, or to impede justice in some other way. In such cases, upon grounds of policy the separate entity is treated as a mere disguise which can not serve to protect the guilty. Such cases are necessary exceptions to the rule that the separate entity authorized by law is to be respected. It is obvious that the general rule and not the exception must govern a case where individuals have seen fit to obtain the advantages of transacting business through the corporate form and only seek to have the distinction between the corporation and its stockholders disregarded when a tax or other obligation can be avoided by doing so.

Congress has always recognized the distinction between a corporation and its stockholders in the Revenue Acts. Beginning with the Tariff Act of October 3, 1913, individuals and corporations have

been taxed separately[3] and dividends have been included in gross income both of individuals and corporations.

The only instance where Congress has provided for a qualified recognition for tax purposes of the community between controlling stockholder and corporation is in some of the provisions for consolidated returns. Beginning with the administration of the war income and excess-profits tax provisions of the Revenue Act of October 3, 1917 (c. 63, 40 Stat. 300), it was found that in order to avoid the excess-profits taxes imposed by that Act upon income falling within the higher brackets many corporations were creating subsidiaries and artificially apportioning thereto a part of their net profits. See *Pelican Ice Co.* v. *Commissioner,* 37 F. (2d) 285, 286 (C. C. A. 5th). To correct this situation and avoid the effect of the division of the income of a single enterprise among several taxable entities, Articles 77 and 78 of Treasury Regulations 41 were promulgated, requiring, among

[3] Subsections (A)(1), (B) and (G) of Section II, Tariff Act of October 3, 1913 (c. 16, 38 Stat. 114, 116); Sections 1, 2, and 10, Revenue Act of 1916 (c. 463, 39 Stat. 756, 757, 765); Sections 1, 4, and 201, Revenue Act of October 3, 1917 (c. 63, 40 Stat. 300, 302, 303); Sections 210, 213, and 230, Revenue Acts of 1918 (c. 18, 40 Stat. 1062, 1065, 1075), 1921 (c. 136, 42 Stat. 233, 237, 252), 1924 (c. 234, 43 Stat. 253; U. S. C., Title 26, Secs. 951, 954, and 981), and 1926 (c. 27, 44 Stat. 9; U. S. C. Sup. V, Title 26, Secs. 951, 954, and 981), and Sections 11, 13, and 22 of the Revenue Acts of 1928 (c. 852, 45 Stat. 791; U. S. C. Sup. V, Title 26, Secs. 2011, 2013, and 2022) and 1932.

other things, that corporations owned by a single stockholder or by the same interests should file a consolidated return. The underlying purpose of Articles 77 and 78 was carried forward and incorporated in modified form in Section 240 of the Revenue Acts of 1918, 1921, 1924, and 1926, and in Section 141 of the Revenue Acts of 1928 and 1932.

This legislation was designed to authorize the Commissioner to disregard the distinction between corporations and corporate stockholders where all were engaged in a single business enterprise. See *Handy & Harman* v. *Burnet,* 284 U. S. 136. That Congress was of the view that the Commissioner would not otherwise have had the power to so disregard the distinction between a corporation and its stockholders may be inferred from the fact that it deemed it necessary to extend such authority specifically by enacting the above legislation and to sanction retroactively Articles 77 and 78 of Treasury Regulations 41, *supra.*[4]

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[4] When H. R. 8245, which later became the Revenue Act of 1921, first passed the House of Representatives, section 1007 related to the validation of articles 77 and 78, *supra.* Concerning the purpose of this section the Committee on Ways and Means, in reporting the bill to the House, said (H. R. 350, 67th Cong., 1st Sess., p. 16):

"Section 1007: For the year 1917 affiliated corporations were permitted or required to make consolidated returns for the purpose of the excess-profits tax. *Owing to the equivocal language employed in the act of October 3, 1917, some doubt exists concerning the legality of this procedure. In order to set all doubts at rest, section 1007 validates the practice of the Treasury Department* under the revenue act

Thus, in all of the Revenue Acts enacted under the Sixteenth Amendment Congress has, except in cases falling under the provisions relating to the filing of consolidated returns, regarded corporations as taxable entities separate and distinct from their stockholders, and has applied this rule whether the corporate stock was owned by one person or by many.

With the possible exception of two cases,[5] this Court has uniformly applied to tax cases the general rule that a corporation is separate from its stockholders, and thus has carried out the purpose of Congress that the separate identity is to be maintained. *Planters' Cotton Oil Co.* v. *Hopkins, supra; Eisner* v. *Macomber,* 252 U. S. 189; *Peabody* v. *Eisner,* 247 U. S. 347; *Lynch* v. *Hornby,* 247 U. S. 339. Of course it may be said that even if Congress had not indicated its purpose to treat corpo-

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of 1917. Such validation is particularly necessary as the taxation of the largest corporations is determined on the basis of the consolidated return." (Italics ours.)

When the bill reached the Senate section 1331 was substituted for section 1007, and the Committee on Finance, in reporting the bill to the Senate, used substantially the same language as that of the Committee on Ways and Means above quoted. (Senate Report No. 275, to accompany H. R. 8245, 67th Cong., 1st sess., p. 34.) As the bill finally emerged Section 1331 retroactively validated the principal provisions of Articles 77 and 78.

[5] These are *Southern Pacific Co.* v. *Lowe,* 247 U. S. 330, and *Gulf Oil Corp.* v. *Lewellyn,* 248 U. S. 71, relied on by the court below and distinguished, *infra,* p. 16 *et seq.*

rations and their stockholders separately for tax purposes the general rule would be applied in tax cases as it is in other cases, in the absence of statutory provision to the contrary.

Not only is the decision of the court below contrary to the purpose of Congress and the decisions of this Court which have been cited, but it is also contrary to the clear weight of authority in the other Federal courts. *The Falk Corporation* v. *Commissioner* (C. C. A. 7th), decided July 6, 1932, reported in Prentice Hall Tax Service, 1932, Vol. I, p. 1972; *Gossett* v. *Commissioner,* decided June 13, 1932, reported in 59 F. (2d) 365 (C. C. A. 4th); *Burnet* v. *Riggs National Bank,* 57 F. (2d) 980 (C. C. A. 4th); *Dalton* v. *Bowers,* 56 F. (2d) 16 (C. C. A. 2d), now pending in this Court on certiorari, No. 52, October Term, 1932; *Athol Manufacturing Co.* v. *Commissioner,* 54 F. (2d) 230 (C. C. A. 1st); *Planters' Cotton Oil Co.* v. *Hopkins,* 53 F. (2d) 825, 827 (C. C. A. 5th), affirmed, 286 U. S. 332; *American Printing Co.* v. *United States,* 53 F. (2d) 98 (D. Mass.); *McDonald* v. *Commissioner,* 52 F. (2d) 920, 922 (C. C. A. 4th); *Darby-Lynde Co.* v. *Commissioner,* 51 F. (2d) 32, 33 (C. C. A. 10th); *Nixon* v. *Lucas,* 42 F. (2d) 833, 834 (C. C. A. 2d); *Wagner* v. *Lucas,* 38 F. (2d) 391, 392 (App. D. C.); *Insurance & Title Guarantee Co.* v. *Commissioner,* 36 F. (2d) 842, 843 (C. C. A. 2d), certiorari denied, 281 U. S. 748; *Goldberg* v. *Commissioner, supra,* 36 F. (2d) 551, 552 (App. D. C.); *Langstaff* v. *Lucas,* 9 F. (2d) 691 (W. D. Ky.),

affirmed, 13 F. (2d) 1022 (C. C. A. 6th), certiorari denied, 273 U. S. 721; *Meischke-Smith* v. *Wardell,* 286 Fed. 785 (C. C. A. 9th), certiorari denied, 263 U. S. 699; *Walker* v. *Gulf & I. Ry. Co. of Texas,* 269 Fed. 885 (C. C. A. 5th).

These decisions all apply the general rule that the separate entity of a corporation is to be recognized in tax cases.

So far as we know the only decisions of lower Federal courts which, like the decision of the court below, seem to be opposed to the weight of authority are *National Slag Co.* v. *Commissioner,* 47 F. (2d) 846 (C. C. A. 3d); *Washburn* v. *Commissioner,* 51 F. (2d) 949 (C. C. A. 8th); and *Clark* v. *Burnet,* decided April 11, 1932, reported in 59 F. (2d) 1031 (App. D. C.). The *National Slag Co.* case was also decided by the court below. It involved the question presented in *Planters' Cotton Oil Co.* v. *Hopkins, supra,* in which the Circuit Court of Appeals refused to follow the decision in the *National Slag Co.* case, and was affirmed by this Court, 286 U. S. 332. Thus the *National Slag Co.* case can no longer be regarded as authority. The *Washburn* and *Clark* cases involved the question presented in *Dalton* v. *Bowers,* now pending in this Court, No. 52, October Term, 1932. The decisions in those cases are contrary to the decision in the *Dalton* case, and we believe that they are erroneous. The Government has filed a petition for certiorari in the *Clark* case, No. 180, October Term, 1932.

The court below seems to have based its decision in part on the view that the taxpayer was an agent of the Widener estate. It is settled that a subsidiary corporation is not the agent of a parent company. *Cannon Manufacturing Co.* v. *Cudahy Packing Co., supra,* 267 U. S. 333, 335, 337; *People's Tobacco Co.* v. *American Tobacco Co., supra,* 246 U. S. 79; *Philadelphia & Reading Ry.* v. *McKibbin,* 243 U. S. 264, 268; *Peterson* v. *Chicago, Rock Island & Pacific Ry., supra,* 205 U. S. 364, 392; *Conley* v. *Mathieson Alkali Works, supra,* 190 U. S. 406, 408, 411–412. There is no more reason to hold that a corporation is the agent of its sole stockholder where the stockholder is not a parent company but an individual or an estate. In any ordinary business transaction it seems clear that it would be incorrect to regard the corporation as agent for its sole stockholder. We believe that the view of the court below, that the corporation was an agent for the stockholder, is really based upon the same view which induced the court below to hold that the corporate entity was to be disregarded, and is equally erroneous.

The court below considered the decisions of this Court in *Southern Pacific Co.* v. *Lowe, supra,* 247 U. S. 330, and *Gulf Oil Corporation* v. *Lewellyn, supra,* 248 U. S. 71, as controlling in principle in the decision of this case. We believe that those decisions are distinguishable and that they are not controlling in the situation presented here.

In *Southern Pacific Co.* v. *Lowe, supra,* the Southern Pacific Company owned all the stock of the Central Pacific Railway Company and operated all of the physical properties of the latter company under a lease. The provisions of the lease were observed by both corporations for bookkeeping purposes. The Southern Pacific Company acted as cashier and banker for both companies. The Central Pacific Company kept no bank account, its earnings being deposited in the bank account of the Southern Pacific Company, the latter company advancing to the former funds as needed. As of March 1, 1913, the Central Pacific Company's books showed a large surplus, principally in the form of a debit against the Southern Pacific Company.

During 1914 the directors of the Central Pacific Company declared dividends out of this surplus, but the payment was carried out by bookkeeping entries only, which simply reduced the apparent indebtedness of the Southern Pacific to the Central Pacific by precisely the amount of the dividends. The Commissioner of Internal Revenue sought to tax such dividends as income accruing in 1914. This Court held that the surplus had accrued to the Southern Pacific Company prior to 1913 and that the declaration and entry of a dividend merely evidenced in form that which in substance had formerly occurred. While the Court said (p. 337)—

> * * * While the two companies were separate legal entities, yet in fact, and for all practical purposes they were merged, the former being but a part of the latter, acting merely as its agent and subject in all things to its proper direction and control—

the decision was expressly limited as follows (p. 338):

> The case turns upon its very peculiar facts, and is distinguishable from others in which the question of the identity of a controlling stockholder with his corporation has been raised.

As limited to the facts before the Court, the decision may be regarded as holding merely that money borrowed by a stockholder from a corporation in which he holds all of the stock may, under the circumstances disclosed in that case, be treated as a dividend and hence as income when the money is received. So viewed, the decision is in harmony with more recent decisions holding that no formal declaration of a dividend is necessary where substantially all the corporate stock is owned by a single stockholder. See *Christopher* v. *Burnet*, 55 F. (2d) 527, 528 (App. D. C.); *Hadley* v. *Commissioner*, 36 F. (2d) 543 (App. D. C.); *Chattanooga Savings Bank* v. *Brewer*, 17 F. (2d) 79 (C. C. A. 6th), certiorari denied, 274 U. S. 751; *Atherton* v. *Beaman*, 264 Fed. 878 (C. C. A. 1st). The principle of those decisions clearly has no bearing upon the question now presented.

The scope of the decision in the *Southern Pacific Company* case was considered by the Circuit Court of Appeals for the Second Circuit in *Nixon* v. *Lucas, supra,* 42 F. (2d) 833. In the *Nixon* case, partners owned all the stock in a corporation and made certain loans to it, for which they were to receive any profits by way of recoupment.

In the tax years in question, the corporation sustained losses which the partners sought to deduct from their income-tax returns, asserting that the company had no actual existence and that the company was really a branch of the partnership business, and that the corporate entity should be disregarded. The taxpayers relied upon *Southern Pacific Co.* v. *Lowe.* The court held that the *Southern Pacific Company* case was not controlling, saying (p. 835):

> Yet we are disposed to regard it as controlling that the relations between the corporations came into being before the passage of the Sixteenth Amendment. The taxpayer had had power to declare the earnings as dividends before there was any tax, and as nothing turned upon the time when it did so, the whole matter being formal in any case, it was safe to assume that its inaction was due to its failure to anticipate the new tax. That gave warrant for ignoring the formal relations between the two. * * *

It seems apparent, therefore, that the decision of this Court in the *Southern Pacific Co.* case should not be regarded as laying down any general rule

authorizing the disregard of corporate entities in tax cases, and that it should be limited to its particular facts.

The exact basis of this Court's decision in *Gulf Oil Corp.* v. *Lewellyn, supra,* 248 U. S. 71, is not readily apparent. There the Gulf Oil Corporation held all the stock of other corporations, all being engaged in the single enterprise of buying, transporting, refining, and selling oil. As stated in the opinion (p. 72):

> The subsidiary companies had retained their earnings, although making some loans *inter se,* and all their funds were invested in properties or actually required to carry on the business, so that the debtor companies had no money available to pay their debts. In January, 1913, the petitioner [parent company] decided to take over the previously accumulated earnings and surplus and did so in that year by votes of the companies that it controlled.

The fact that the earnings had accumulated, and had been used as capital, before March 1, 1913, seems to have been the factor justifying the application of the decision in *Southern Pacific Co.* v. *Lowe.*[6] See *Walker* v. *Gulf & I. Ry. Co. of Texas,*

[6] This is indicated by the fact that the Court thought that its decision in *Lynch* v. *Turrish,* 247 U. S. 221, had some application. It said (248 U. S. 71, 72): "The earnings thus transferred had been accumulated and had been used as capital before the taxing year. *Lynch* v. *Turrish,* 247 U. S. 221, 228."

Lynch v. *Turrish* involved a liquidation and final distribution by a corporation in 1914 of corporate assets which

269 Fed. 885, 890 (C. C. A. 5th); *Meischke-Smith* v. *Wardell*, 286 Fed. 785, 791–792 (C. C. A. 9th), certiorari denied, 263 U. S. 699.

We believe that the *Gulf Oil Corporation* case, like the *Southern Pacific Co.* case, is to be regarded as limited to its particular facts and as not laying down any general rule requiring the disregard of corporate entities in tax cases or as controlling decision here.

The decision of the court below is without support in decisions of this Court. It is clearly contrary to the weight of authority in other Federal courts. It disregards the purpose of Congress to treat corporations and their stockholders separately. We believe that the decision is erroneous and should be reversed.

II

THE DETERMINATION OF GAIN BY THE COMMISSIONER WAS CORRECT

On March 1, 1913, respondent owned 225,000 shares of British-American Tobacco Company stock having a fair market value of $5,315,625 or $23.625 per share. In 1919 through the exercise of rights growing out of such ownership it acquired 75,000 additional shares at a total cost of $326,437.50, or $4.3525 per share. (R. 5, 11.) In 1920 it exchanged the certificates representing the 225,000

---

had not increased in value since March 1, 1913, but had increased in value during the corporate tenure prior thereto. It was held that the difference between the cost and the March 1, 1913, value did not accrue as a profit during 1914.

original shares for property having an admitted value of $5,287,500. In determining respondent's gain per share the Commissioner divided the total of the March 1, 1913, value of the 225,000 shares and the cost of the 75,000 shares by the total number of shares, thus determining a cost base per share of $18.806875 (R. 11) and a profit of $1,055,-953.12 instead of a loss of $28,125, as claimed by respondent (R. 3–5).

The Commissioner's action was in accordance with Article 39 of Treasury Regulations 45 (1920 Edition) as amended by T. D. 3402, I–2 C. B. 63 (*supra*, p. 3), construing the provisions of Section 202 of the Revenue Act of 1918 (*supra*, p. 2).[7] Treasury Decision 3402 was promulgated October 18, 1922, following the decision of this Court in *Miles* v. *Safe Deposit Co.*, 259 U. S. 247 (decided May 29, 1922). The regulation as so amended conforms to the rule approved in that decision.

The substance of Treasury Decision 3402 was carried forward into Article 39 of Treasury Regulations 65 and 69[8] and Article 58 of Treasury Regulations 74. The material provisions of Section 202 of the Revenue Act of 1918 have been reenacted in Section 202 of the Revenue Act of 1921 (c. 136, 42

[7] Section 202 directs that in ascertaining the gain derived or the loss sustained from the final disposition of property the basis shall be the March 1, 1913, value if acquired prior thereto, or the cost if acquired subsequently.

[8] Article 39 of Treasury Regulations 69 adopted a slightly different method of computing gain; however, the result under either method is always substantially the same.

Stat. 229), Section 204 of the Revenue Act of 1921 (c. 136, 42 Stat. 231), Section 204 of the Revenue Acts of 1924 (c. 234, 43 Stat. 258; U. S. C., Title 26, Sec. 935) and 1926 (c. 27, 44 Stat. 14; U. S. C. App. V, Title 26, Sec. 935), and Section 113 of the Revenue Acts of 1928 (c. 852, 45 Stat. 818; U. S. C. Sup. V, Title 26, Sec. 2113) and 1932 (Pub. No. 154, 72d Cong.). Reenactment of the statute after such administrative construction imports legislative approval thereof. *Brewster* v. *Gage,* 280 U. S. 327, 337; *McCaughn* v. *Hershey Chocolate Co.,* 283 U. S. 488, 492–493.

In *Ayer* v. *Blair,* 25 F. (2d) 534, the Court of Appeals of the District of Columbia had before it the precise question here presented and upon authority of the decision of this Court in *Miles* v. *Safe Deposit Co., supra,* sustained the action of the Commissioner. As early as 1921 the United States District Court for the Southern District of New York, in *Towne* v. *M'Elligott,* 274 Fed. 960, directed the computation of a tax upon the same basis. These decisions were followed and applied in *Hewes* v. *Eaton,* 39 F. (2d) 917 (Conn.), and so far as we have been able to ascertain there are no decisions to the contrary.

We believe that the Commissioner's computation of the tax, which was approved by the Board of Tax Appeals and was not considered by the court below, was correct, and that upon reversal of the court below the decision of the Board of Tax Appeals should be affirmed.

CONCLUSION

It is respectfully submitted that the decision of the court below should be reversed and the decision of the Board of Tax Appeals should be affirmed.

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OCTOBER, 1932.

U. S. GOVERNMENT PRINTING OFFICE: 1932

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No. [redacted].95 OCTOBER TERM, 1931.

IN THE

Supreme Court of the United States

DAVID BURNET, COMMISSIONER OF INTERNAL REVENUE, Petitioner,

v.

COMMONWEALTH IMPROVEMENT COMPANY, Respondent.

BRIEF IN OPPOSITION TO PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE THIRD CIRCUIT.

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In the Supreme Court of the United States.

OCTOBER TERM, 1931. No. .

David Burnet, Commissioner of Internal Revenue, Petitioner,

v.

Commonwealth Improvement Company, Respondent.

BRIEF IN OPPOSITION TO PETITION FOR A WRIT OF CERTIORARI.

COUNTER-STATEMENT OF QUESTION PRESENTED.

Whether a Court is obliged to hold that an apparent profit resulting from a transaction between a corporation and its sole stockholder

is a taxable gain under Section 202 of the Revenue Act of 1918 because the corporation and the stockholder are separate entities in law, or whether that Court has discretion to examine the facts and circumstances of the particular transaction to determine if a gain in substance has been realized or a gain in form only.

ARGUMENT.

We respectfully submit that the petition for writ of certiorari should be denied. The decision of the Circuit Court of Appeals in this case (1) is not in conflict with decisions of other Circuit Courts, nor can the decision (2) be of "great general importance in administering the income tax laws" (Petition, 5) because it is purely a fact decision which, by its very language, is applicable only to the particular facts in issue. These two statements specifically controvert the two reasons advanced by the learned Solicitor General (Petition, 4, 5) for granting this writ.

The Solicitor General errs in stating that the decision of the Circuit Court of Appeals is in conflict with cited decisions of the Circuit Court of Appeals for the Second Circuit, for the Fifth Circuit, and for the District of Columbia, in that, in his view, the decision in the instant case stands

for the general proposition that where an individual or an estate owns all the stock of a corporation, the separate entity of the corporation should be disregarded for Federal tax purposes. The decision in the instant case does not so hold, but on the contrary it is based solely upon a principle long recognized by this Court in tax cases, to wit, that the substance of a transaction rather than its form must prevail. The accuracy of our statement cannot be more clearly demonstrated than by quoting from the opinion of the Circuit Court of Appeals in the instant case (R. 53, 54):—

> **"The taxpayer, itself, concedes that it and the estate are distinct beings in contemplation of the law and subject to the burdens thereof. But the taxpayer asks this court to deny the Government's right to tax gains, profits, or income that are illusory, and do not exist in fact.**
>
> **"By determining whether this court has the power to examine this exchange of property for its substance, we come to the ultimate questions in this case: (a) Is there any real gain or loss to be taxed? and (b) did Congress intend to tax that which is income in form only?**
>
> **"Counsel for the taxpayer have offered two cases, which they frankly admit do not control this case on its facts, to show that we may**

examine the transaction here concerned for its substance as an incidence to income taxation. Southern Pacific Company v. Lowe, 247 U. S. 330; Gulf Oil Corporation v. Llewellyn, 248 U. S. 71."

* * * * * * *

"The point comes down to this: Did Congress intend that 'income' should be used as a word of art or in a real and practical sense?"

We submit that the whole opinion of the Circuit Court of Appeals in the instant case, and in particular those portions which we have quoted above, make it clear that the Court did not view the *Southern Pacific* and the *Gulf Oil* cases as precedents for the general proposition that separate entities of individual and corporation are to be disregarded in tax cases, but that the Court viewed these two decisions simply as giving it *discretion* to examine a transaction in issue to ascertain whether or not that particular transaction produced income in fact as contrasted with income in form only. Disregard of the corporate entity of the taxpayer, if it can be said to have been disregarded, was only an incident in the result. This being so, it is plain that the decision in the instant case cannot conflict with decisions of other Circuits which may have held that, under other facts, such entities were of the essence of the particular transactions or

situations and so determinative of actual profit or loss.

It necessarily follows that the instant case cannot be of "great general importance in administering the income tax laws," as is stated by the learned Solicitor General, and that in fact the only interest of the Government in this case is the amount of tax specifically in issue. As indicated by the opinion of the Circuit Court of Appeals, the primary question was whether in this case the particular transaction resulted in such a profit as was taxable under the general principles of *Eisner* v. *Macomber,* 252 U. S. 189. That being so, the decision is purely a factual decision. We submit that the whole opinion of the Circuit Court of Appeals not only demonstrates the correctness of our statement in this respect, but that the Court took particular pains in certain portions of its opinion to make this point so clear that no one could thereafter attempt to use its decision as a precedent for the proposition as to which the learned Solicitor General is apprehensive. For example, we quote from the opinion (R. 52, 53, 55) as follows:—

> **"This petition for review concerns income and excess profits taxes for the year 1920. The extraordinary situation here arises out of the relation of the taxpayer to the estate of P. A. B. Widener."**
>
> * * * * * * *

"And, thus, came about the unusual situation which brings us to the issue in this case."

* * * * * * *

"The profit resulting to the taxpayer is illusory and non-existent. The law is interested in an income from which an economic benefit may be realized."

We respectfully submit that these quoted portions from the opinion, particularly when read with the whole opinion, very definitely limit the decision to the particular facts before the Court below.

As we have said, and as that Court specifically stated in its opinion, the primary question in the instant case was *not* whether the separate entity of a corporation (Commonwealth Improvement Company) should be disregarded, but whether, on the particular facts, a profit in substance was realized. The Court below discusses these facts at length in its opinion, but they may be very briefly summarized by saying that in 1912 Mr. Widener desired to place a lien on his fortune to insure an endowment for a charity, The Widener Memorial School for Crippled Children, and that he did so by transferring the bulk of his fortune to the taxpayer, the Commonwealth Improvement Company (R. 17, 18). The taxpayer then issued its debentures and other securities to Mr.

Widener, who in turn placed a portion of the debentures in trust for the charity (R. 17, 18). In 1920, after Mr. Widener's death, it was deemed advisable by his Trustees to substitute certain real estate bonds owned by the Widener Estate as endowment for the charity in lieu of the debentures (R. 19). At this time part of the Widener Estate was administered directly by the Trustees and part by the Trustees through the taxpayer, the Trustees and their counsel being its officers, directors and sole stockholders (R. 18). The substitution of bonds for debentures was accomplished by the Trustees of the Estate delivering the bonds to the charity in exchange for the taxpayer's debentures (R. 19). The Trustees then transferred the debentures and certain other securities to the taxpayer in exchange for a block of stock of substantially greater market value, the transaction being balanced by a bookkeeping credit in favor of the taxpayer (R. 20). The debentures were cancelled, so that the net result to the Widener Estate as an entity was that it had received back from the charity obligations of the taxpayer of a face value of $4,000,000, and had given to the charity real estate bonds of a like face value (R. 19, 20). The subsidiary transfer between the Trustees of the Widener Estate and the incorporated portion of the Estate, to wit, the taxpayer, was balanced by book entries as

was the custom when it seemed desirable to shift funds or securities from one hand to the other (R. 19), and did not add or subtract one penny from the net worth of the Estate or the taxpayer. This point was made clear by the Circuit Court of Appeals in the following quotation from its opinion (R. 55):—

> **"Obviously, in actual dollars and cents, it made no difference to the estate, itself, whether or not they obtained anything in return; but, in order to balance the books, the block of British-American Tobacco stock was taken, as its then value was substantially the same as on March 1, 1913, and was the largest single block standing in the taxpayer's name.**
>
> **"The stock was transferred, and to offset the balance due the taxpayer on the exchange, it was given credit on its books. The result of the transaction produced no gain, nor loss, nor income to either the taxpayer or the Widener estate."**

It will be noted that the taxpayer was never more than a holding company (R. 17, 18, 19, 20) and was never engaged in separate business ventures as were the corporations in the *Nixon, Wagner, Goldberg* and *Planter's Cotton Oil* cases cited by the Solicitor General on pp. 8 to 11 of his Brief. Furthermore, that at the time the

transaction was effected in 1920 there was not even a bookkeeping profit to the taxpayer, but that subsequently the regulations of the Treasury Department were changed by Treasury Decision 3402 approved October 18, 1922, following the decision of this Court in *Miles* v. *Safe Deposit Company,* 259 U. S. 247, with the result that a taxable profit on paper was created of approximately $1,000,000. It is this paper profit which the Circuit Court of Appeals held to be a profit in form and not in substance.

The learned Solicitor General argues on page 11 of his Brief that we should not be permitted now to deny the separate character of the taxpayer and the Widener Estate because (1) the taxpayer in its return for 1920 claimed a loss resulting in part from the particular transaction; (2) the taxpayer has paid its taxes at corporate rather than individual or estate rates; and (3) the transfer by Mr. Widener to the taxpayer of his non-Pennsylvania stocks resulted in the avoidance of estate taxes outside of Pennsylvania. We reply that there can be no estoppel against the taxpayer on any of these grounds, but beyond this, that they do not serve to shift the equities from the taxpayer to the petitioner.

As to the first point, it is sufficient to say that taxpayer's return for 1920 was filed to conform with its books of account, and that the loss

claimed was purely nominal and without result on tax liability because its disallowance resulted only in reducing the amount of the taxpayer's loss for the year (R. 10, 11). Furthermore, we offered to prove at the trial of this case that the Commissioner of Internal Revenue settled taxpayer's returns for prior years on the basis that a comparatively small apparent profit to the taxpayer in 1917 and a comparatively small apparent loss to the Widener Estate in 1919, both of which resulted from transactions between the taxpayer and the estate, were to be disregarded because of the identity of the two (R. 45, 46, 47). The refusal of the Board of Tax Appeals to receive such proofs was assigned as error in our Petition for Review to the Circuit Court of Appeals (R. 30, 31).

As to the second point, that the taxpayer has benefited by paying its taxes at corporate rates, we suggest that it has always been open to the Government to correct any abuse in this respect as between the taxpayer and its sole stockholder, the Widener Estate, by invoking the provisions of Section 220 of the Revenue Act of 1918 (see Appendix) or like provisions of other Revenue Acts.

As to the third point, that the Widener Estate benefited because its use of the taxpayer avoided

estate taxes on Mr. Widener's death to other sovereignties than Pennsylvania, we need only point out that when Mr. Widener died there was no Federal Estate Tax, and that as Pennsylvania was his domicile, the result accomplished was the result approved by this Court in *First National Bank of Boston* v. *Maine,* 284 U. S. 312.

Finally, we submit that such portion of the petitioner's brief as is devoted to an apparent conflict between the decision in the instant case and that of the Court of Appeals of the District of Columbia in *Ayer* v. *Blair,* 25 Fed. (2d Ed.) 534, may be disregarded. That case dealt with the validity of Article 39, as amended, of Treasury Regulations 45, and as stated by the learned Solicitor General (Petition, 3, 4). The Court below found it unnecessary to pass upon this question inasmuch as it disposed of the case upon the larger question, to wit, whether or not income in fact had been realized.

CONCLUSION.

We therefore respectfully submit, in conclusion, that the petition for writ of certiorari should be denied because the decision of the Court below is not in conflict with the decisions of any other Circuit Court of Appeals, but is purely a factual

decision; that the Court found its authority for examination of the facts under a long recognized principle, to wit, that in questions of income taxation the substance and not the form must prevail; and that under these circumstances the decision of the Court below cannot be of any great general importance in administering the tax laws, but can only be of importance to the Government with respect to the specific amount of tax involved.

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APPENDIX.

Revenue Act of 1918, c. 18, 40 Stat. 1057, Section 220.

SEC. 220. That if any corporation, however created or organized, is formed or availed of for the purpose of preventing the imposition of the surtax upon its stockholders or members through the medium of permitting its gains and profits to accumulate instead of being divided or distributed, such corporation shall not be subject to the tax imposed by section 230, but the stockholders or members thereof shall be subject to taxation under this title in the same manner as provided in subdivision (e) of Section 218 in the case of stockholders of a personal service corporation, except that the tax imposed by Title III shall be deducted from the net income of the corporation before the computation of the proportionate share of each stockholder or member. The fact that any corporation is a mere holding company or that the gains and profits are permitted to accumulate beyond the reasonable needs of the business, shall be *prima facie* evidence of a purpose to escape the surtax; but the fact that the gains and profits are in any case permitted to accumulate and become surplus shall not be construed as evidence of a purpose to escape the tax in such case

unless the Commissioner certifies that in his opinion such accumulation is unreasonable for the purposes of the business. When requested by the Commissioner, or any collector, every corporation shall forward to him a correct statement of such gains and profits and the names and addresses of the individuals or shareholders who would be entitled to the same if divided or distributed, and of the amounts that would be payable to each.

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IN THE

Supreme Court of the United States

No. 95. OCTOBER TERM, 1932.

DAVID BURNET, COMMISSIONER OF INTERNAL REVENUE, Petitioner,

v.

COMMONWEALTH IMPROVEMENT COMPANY.

ON WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE THIRD CIRCUIT.

BRIEF FOR THE RESPONDENT.

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In the Supreme Court of the United States.

OCTOBER TERM, 1932. No. 95.

David Burnet, Commissioner of Internal Revenue, Petitioner,

v.

Commonwealth Improvment Company.

ON WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE THIRD CIRCUIT.

BRIEF FOR THE RESPONDENT.

OPINIONS BELOW.

The opinion of the Board of Tax Appeals (R. 11-14) is reported in 20 B. T. A. 1189. The opinion of the Circuit Court of Appeals for the Third Circuit (R. 29-33) is reported in 57 F. (2d) 47.

JURISDICTION.

The judgment of the Circuit Court of Appeals was entered March 17, 1932 (R. 33). The petition for certiorari was filed May 23, 1932, and was granted May 31, 1932. Jurisdiction is conferred upon this Court by Section 240 (a) of the Judicial Code, as amended by the Act of February 13, 1925.

COUNTER-STATEMENT OF QUESTIONS PRESENTED.

1. Must an apparent profit resulting from a transaction between a corporation and its sole stockholder be held a taxable gain under Section 202 of the Revenue Act of 1918 because the corporation and the stockholder are separate entities in law, or may the facts and circumstances of the particular transaction be examined to determine if a gain in substance has been realized or a gain in form only?

2. Should the March 1, 1913, value of shares of stock be decreased under Section 202 of the Revenue Act of 1918 by reason of the exercise of stock rights issued to the holder at a subsequent date, when the identical shares held on March 1, 1913, were disposed of after the subscription and the identical shares acquired on subscription were retained?

STATUTE AND REGULATIONS INVOLVED.

Revenue Act of 1918, c. 18, 40 Stat. 1057:—

> SEC. 202. (a) That for the purpose of ascertaining the gain derived or loss sustained from the sale or other disposition of property, real, personal, or mixed, the basis shall be—
>
> (1) In the case of property acquired before March 1, 1913, the fair market price or value of such property as of that date; and
>
> (2) In the case of property acquired on or after that date, the cost thereof; or the inventory value, if the inventory is made in accordance with section 203.
>
> (b) When property is exchanged for other property, the property received in exchange shall for the purpose of determining gain or loss be treated as the equivalent of cash to the amount of its fair market value, if any; * * *.

Article 39 of Treasury Regulations 45 as promulgated April 17, 1919, and in effect during 1920:—

> ART. 39. Sale of stock and rights.—When shares of stock in a corporation are sold from lots purchased at different times and at different prices and the identity of the lots can not be determined, the stock sold shall be charged against the earliest purchasers of

such stock. The excess of the amount realized on the sale over the cost of the stock, or its fair market value as of March 1, 1913, if purchased before that date, will be the profit to be accounted for as income. * * *

* * * * * * *

The entire amount realized from the sale of rights to subscribe for stock is income.

Article 39 of Treasury Regulations 45 (1920 Edition), as amended by Treasury Decision 3402, I-2 C. B. 63, promulgated October 18, 1922:

ART. 39. Sale of stock and rights.— * * * Where a corporation issues to its stockholders the right to subscribe to its stock, the value of the right does not constitute taxable income to the stockholder, but gain may be derived or loss sustained by the stockholder from the sale of such right. * * *:

* * * Where the stockholder exercises his right to subscribe to new stock of substantially the same character or preference as the stock with respect to which the right is issued, the cost of the old and new shares (or, if acquired prior to March 1, 1913, the fair market value as of that date) will be the quotient of the cost of the old shares, plus the subscription price of the new shares, divided by the total number of the old and new shares. * * *

COUNTER-STATEMENT.

The Commonwealth Improvement Company was granted a special charter under the laws of Pennsylvania prior to 1874. In 1911, Ellis Ames Ballard, who was then counsel for the late P. A. B. Widener, suggested to the latter's son, George D. Widener, that his father's holdings in corporations other than Pennsylvania corporations be placed in a corporation in order to avoid extraterritorial estate and succession taxes upon his father's death. The number of securities possibly subject to such taxes was very great because of the dissolution at that time of the Standard Oil and American Tobacco Companies. George D. Widener approved of the suggestion and at his instance Mr. Ballard bought all of the outstanding shares of Commonwealth Improvement Company. When, however, the proposal was suggested to P. A. B. Widener, he was not interested, and the matter remained in abeyance until after George D. Widener's death in the "Titanic" disaster on April 12, 1912 (R. 9, 19-20).

In the meantime, P. A. B. Widener had built the Widener Memorial School for Crippled Children in Philadelphia. After his son's death, he asked Mr. Ballard to suggest a plan by which an endowment could be provided for this charity which would in effect be a lien against his

fortune. Mr. Ballard pointed out that under the law of Pennsylvania a lien could not be created upon personal property but suggested that substantially all of Mr. Widener's securities be transferred to Commonwealth Improvement Company and that Commonwealth then issue its debentures to a trustee for the charity. Mr. Widener approved of this plan and as of May 1, 1912, securities of an approximate market value of $25,000,000 were transferred by Mr. Widener to Commonwealth in exchange for its securities of like face value. $4,000,000 of Commonwealth's "A" Debentures were deposited with The Land Title and Trust Company, in trust, as a perpetual endowment for the charity (R. 9-10, 20-21).

P. A. B. Widener died in 1915 (R. 10, 21). After certain devises and bequests all of his assets, including the securities of Commonwealth Improvement Company (except the $4,000,000 debentures above mentioned), were left to trustees under a long term trust. The trustees were and are Joseph E. Widener and George D. Widener. The directors and officers of Commonwealth were and are Joseph E. Widener, George D. Widener and Mr. Ballard, who since P. A. B. Widener's death has been counsel for his estate. Mr. Ballard has been secretary and treasurer of Commonwealth since May 1, 1912, at a salary which has been understood to cover his services

as counsel for the estate. The trustees of the estate have not received commissions but have been paid salaries as officers of Commonwealth. From Mr. Widener's death in 1915, through 1920, the clerks and bookkeepers of the estate and its office expenses have been paid by Commonwealth. Whenever from time to time Commonwealth or the estate was in need of funds, or either desired stock to hypothecate, and it seemed more desirable that the transaction should be in the one name than in the other, transfers have been made between the two without formal corporate action in the sense of regular stockholders' or directors' meetings, but simply by appropriate book entries made after agreement between those in command, namely, the trustees of the estate (R. 10-11, 21-22).

In 1917 the trustees of the estate decided to reduce the capital structure of Commonwealth from $25,000,000 to $6,000,000, so that there would be left outstanding $2,000,000 of stock instead of $5,000,000 and $4,000,000 of debentures instead of $20,000,000, the $4,000,000 remaining being the debentures deposited in trust for the charity. To accomplish this, the Commonwealth transferred from its name to the name of the estate, securities of a book value of approximately $19,000,000 and the estate surrendered to the

Commonwealth the latter's debentures and stock of a like face value for cancellation. Differences were adjusted by book entries (R. 10, 21-22, 30). At the hearing of the instant case before the Board of Tax Appeals, the respondent offered to prove that revenue agents who audited the accounts of the estate and the Commonwealth for 1917, found an apparent taxable profit to Commonwealth on account of this transaction of $131,000; that this apparent profit was eliminated by them on the ground that it was not a profit in substance, and that this decision had been approved by the Commissioner of Internal Revenue. Counsel for the Commissioner objected to the admission of such evidence; the objection was sustained and an exception granted (R. 22, 25, 26-27). The Board's refusal to accept this evidence is covered in respondent's fourth Assignment of Error in the Court below (R. 17).

Likewise there were transactions between the Commonwealth and the estate in 1919 which created an apparent loss to the estate of $167,000. At the trial of the case before the Board of Tax Appeals respondent offered to prove that revenue agents who had examined the accounts for that year had disallowed this loss for the same reason, namely, that it was not in fact a loss, and that this action had been approved by

the Commissioner of Internal Revenue. Respondent's offer was refused with exception granted, and the action of the Board is covered by respondent's fifth and sixth Assignments of Error in the Court below (R. 26-27, 17-18).

In 1920 the endowment for the Widener Memorial School for Crippled Children consisted of $4,000,000 of Commonwealth debentures. The assets of the Commonwealth had been considerably reduced by the transfers made in 1917 and 1919 and in consequence the trustees decided that it would be sound to substitute bonds to be given by the trustees of the estate and secured by mortgages upon valuable central real estate in Philadelphia. To accomplish this, mortgages for $4,000,000 were created and delivered to the trustee for the charity in exchange for the debentures. The debentures were then surrendered by the estate to the Commonwealth for cancellation. To balance the books, it was determined to transfer securities from the Commonwealth to the estate and a block of 225,000 shares of British-American Tobacco which had a then market value of $5,287,500 was selected for this purpose (R. 11, 23, 30). Mr. Ballard testified that a decision having been reached as to the substitution of mortgages for debentures, it was left to him to settle the form of the transaction, and that he selected this particular block of stock as offering the line of least

resistance inasmuch as it was a single block that had been held by Commonwealth from its organization and had a then market value substantially identical with its market value on March 1, 1913 (R. 23-24). The stock certificates transferred in 1920 were the identical certificates received by Commonwealth from P. A. B. Widener in 1912 (R. 11).

Mr. Ballard stated that it was no essential part of the transaction that the block of British-American Tobacco be transferred at $23.50 per share, but that it could as readily have been transfered at any other price. Likewise he might as well have selected any other security or securities (R. 23-24).

There was at the time a considerable amount owed on the books by Commonwealth to the estate, so that the transaction was closed and the books balanced by cancelling the debentures and the book debt from Commonwealth to the estate, by the transfer of certain other miscellaneous securities and by the setting up of a book charge in favor of the Commonwealth for the balance. No cash passed and the net result of the transaction was that the trustee for the charity held mortgages instead of debentures, the estate had in its name securities which theretofore had been in the name of the Commonwealth, and the books

showed a credit to the Commonwealth instead of a debit (R. 11, 24).

At the time the transaction was closed Art. 39 of Treasury Regulations 45 prescribed that the basis for profit and loss on the 225,000 shares of British-American Tobacco was their March 1, 1913, value or $5,315,625 as against a transfer value in 1920 of $5,287,500. Two years later Art. 39 of said Regulations was amended and the Commissioner of Internal Revenue ruled that the basis of the 225,000 shares of British-American Tobacco must be reduced to $4,231,-566.88 because of the fact that in 1919 Commonwealth acquired 75,000 additional shares by subscription at a cost of $326,437.50. On this basis the Commissioner determined a profit of $1,055,-953.12 and a deficiency in tax of $294,388.42 (R. 5-7, 11-12).

The Board of Tax Appeals sustained the action of the Commissioner (R. 14). Upon petition for review the Circuit Court of Appeals for the Third Circuit reversed, holding that the profit determined by the Commissioner was illusory and nonexistent (R. 29-33). Reaching that conclusion it became unnecessary for the Court to determine the validity of Article 39, as amended, of Treasury Regulations 45, which is embraced in the second question stated, *infra*. This Court granted certiorari.

SUMMARY OF ARGUMENT.

We concede, as we did in the Court below, that a corporation and its stockholders are separate entities in general contemplation of the law, and that this is so whether the stock is divided among many individuals or is in a single hand. Consequently we do not contend for any general rule that transactions between a corporation and its sole stockholder are to be disregarded for tax purposes on a theory of identity of interest. We do argue, however, that the facts of a particular case may be such that no income in substance, and therefore no taxable income, has been realized. In other words, we believe it to be a *non sequitur* that because a corporation and its sole stockholder are separate entities, *every* transaction in *every* such situation which shows a paper profit *must* result in taxable income.

We view this, as did the Court below, as purely a fact case. The Court below found that under the peculiar circumstances the profit was illusory and of form only. It did not regard *Southern Pacific Co.* v. *Lowe,* 247 U. S. 330, and *Gulf Oil Corporation* v. *Lewellyn,* 248 U. S. 71, as controlling, nor do we. The Court below cited and we now offer these cases simply as authority for the position that a court may look behind form, and if it believes that *under the*

particular facts no real income has been realized, it may so rule regardless of general rules of law respecting the status of the parties. It follows that the decision below, being a fact decision, is not and cannot be a precedent except in the single circumstance of a recurrence of the precise state of facts.

Secondarily, we argue that even if there could be a real profit under the facts, the Commission's determination is not in accord with Sec. 202 of the Revenue Act of 1918. That section provides explicitly that the basis for property acquired prior to March 1, 1913, shall be its value on that date, and that for property acquired thereafter, the basis shall be cost. The respondent transferred the identical shares acquired prior to March 1, 1913, and kept the identical shares acquired thereafter. The Commissioner has averaged the March 1, 1913, value and the cost. We say that however desirable this method may be from an accounting standpoint, it is not the method prescribed by Congress; and consequently, that the basis of the shares transferred in 1920 must be their 1913 value, and that no tax can be assessed *qua* the shares bought in 1919 until they are disposed of, and that then the profit must be determined on the basis of their actual cost.

ARGUMENT.

I.

The profit taxed by the Commissioner was not income in fact.

As we have indicated in the immediately preceding section of this brief, we do not take issue with the position of the petitioner that as a general proposition of law a corporation and its stockholders are to be considered as separate entities, and that the same is true whether the stock of the particular corporation is held among many individuals or by a single person or estate as in the instant case. We view the real question in this case as being solely whether or not, under the particular facts, the transaction in question resulted in true income, and therefore, in taxable income. We submit that such a question can be answered only by a consideration of all of the facts, and that the status of the parties as entities is an integral part of those facts; that such status is a measure of the actual character of the particular transaction but not in itself a basis of decision in the sense of establishing a rule applicable generally to tax cases.

Petitioner replies to our view on page 8 of his brief by saying that this particular transaction can only be regarded as non-taxable if the respondent and its sole stockholder are considered as one and the same person and as having no

separate identity; and that the same transaction between respondent and a third person must necessarily have resulted in a taxable profit. The implication is that an affirmance of the Court below must establish a general rule that for tax purposes all transactions between a corporation and its sole owner are to be disregarded. We do not share petitioner's apprehension as to general rules and precedents because in our view every case in which the issue is whether or not income in reality has been realized must of necessity be a case dependent upon its own particular facts, and, therefore, this would be a different case had the transaction, as suggested by the petitioner, been in fact between other parties.

We suggest, for instance, that certain transactions may take place between a corporation and an individual who has no interest as a stockholder or otherwise which may show an apparent profit to one or the other, but which, when analyzed, reveal no real profit. By way of illustration we may refer to the case of *Bowers* v. *Kerbaugh-Empire Company,* 271 U. S. 270, in which a corporation, due to changes in foreign exchange, was able to retire its obligations at a less cost in dollars than the dollar value of the obligations when created. This transaction was between the corporation and third parties; it created an apparent profit and a tax was assessed

thereon by the Commissioner. This Court ruled, however, that no profit in substance had been realized.

Likewise, we suggest that certain transactions between a corporation and its sole stockholder may result in a real income to one or the other, while other transactions between the same parties may create only the appearance of income. If, for instance, a corporation receives income by way of dividends and then itself pays dividends in cash or property, or makes some other distribution to its sole stockholder, obviously both the corporation and its stockholder have successively been in receipt of a real income; or if a corporation is organized to carry on a commercial enterprise and in the ordinary course of that business sells at a profit to its owner, we submit that the corporation has made a true income, but that its stockholder does not participate in the gain for tax purposes until and unless some part of it is distributed to him. In such case the corporation has realized a distinct economic benefit which is not available to its stockholder until distributed. This economic gain was obtained in the course of a commercial enterprise, it being assumed that it was a normal business transaction uninfluenced by the stock control of the owner.

In other words, we must dissent from the

petitioner's view that in order to find that no real income was realized in the instant case it is necessary for the Court to hold that the respondent and its sole stockholder were identical in law or to establish a rule applicable generally to tax cases. So far as the particular case is concerned, it may be that such inference may result from a tax standpoint, but if so, we view this as a result or as an incident to a result rather than as a cause or basis of decision. In any event, however, it is certain that an affirmance of the Court below in the instant case need not mean the promulgation of a general rule that all transactions between a corporation and its sole stockholder are to be disregarded for tax purposes, for whether an apparent unity of the entities be regarded as a reason for the decision or as a result of the decision, or whether a particular case be regarded as an exception to the general rule because of its peculiar facts, it is clear that each such case must be a fact case which cannot thereafter serve as a precedent.

The foregoing general view is clearly the view of the lower Court as appears in the following quotations from its opinion (R. 31, 32, 33):—

> **"The taxpayer, itself, concedes that it and the estate are distinct beings in contemplation of the law and subject to the burdens thereof. But the taxpayer asks this court to deny**

the Government's right to tax gains, profits, or income that are illusory, and do not exist in fact.

"By determining whether this court has the power to examine this exchange of property for its substance, we come to the ultimate questions in this case: (a) Is there any real gain or loss to be taxed? and (b) did Congress intend to tax that which is income in form only?

"Counsel for the taxpayer have offered two cases, which they frankly admit do not control this case on its facts, to show that we may examine the transaction here concerned for its substance as an incidence to income taxation. Southern Pacific Company v. Lowe, 247 U. S. 330; Gulf Oil Corporation v. Lewellyn, 248 U. S. 71."

* * * * * * *

"The point comes down to this: Did Congress intend that 'income' should be used as a word of art or in a real and practical sense?"

* * * * * * *

"The estate owned the taxpayer, and was in control and possession of all of its property. In substance, the taxpayer in this case was a mere agent of the Widener Estate, and did not realize any taxable profit from this

transaction, and so the order of redetermination of the Board of Tax Appeals is reversed."

The petitioner on page 16 of his brief criticizes the last quoted excerpt from the opinion of the lower Court as indicating that the Court based its decision in part on a theory of principal and agent. We submit that as a matter of fact the record makes it clear that the respondent was an agency or instrumentality of the trustees of the Widener Estate in the administration of the trust.

Without denying this fact situation the petitioner cites *Cannon Manufacturing Co.* v. *Cudahy Packing Co.,* 267 U. S. 333, and other cases as authority for the proposition that a subsidiary corporation in law is not an agent of the parent, and by the same reasoning, that a wholly owned subsidiary corporation is not the agent of the individual owner of its shares. We submit that these cases cited do not support such a broad statement. The *Cannon* case, for instance, dealt with a question of jurisdiction, the issue being whether service on a subsidiary alone brought the parent before the Court. This Court decided the issue in the negative, but specifically differentiated cases concerning substantive rights, such as *Chicago, M. & St. P. R. Co.* v. *Minneapolis*

C. & C. Asso., 247 U. S. 490, in which the subsidiary was held for rate purposes to be in effect an agent of the parent companies. We do not, however, argue this point at length because in our view the decision of the Court below was not based on a finding or belief that a formal agency existed. We suggest that its characterization of the respondent as a "mere agent" was simply indicative of its view that this transaction of convenience between the trustees and a wholly controlled instrumentality could not be productive of a profit in fact, whatever might be the accounting or bookkeeping results, and that it used the quoted phrase much as this Court did in the *Chicago M. & St. P.* case, *supra,* in which it was held that the rule as to separate corporate entities could not prevail, at least for rate making purposes, when the stock ownership was acquired, not to participate in the corporate affairs in the normal and usual way, but to control a corporation so that it might be used simply as an instrumentality of the owning companies.

The petitioner also cites a series of cases on pages 14 and 15 of his brief as authority for his general contention that the separate entities of corporation and stockholder must be recognized regardless of the facts, with the result, as he argues, that the lower court erred in examining the facts to determine the substance of the

transaction. We do not regard the cited cases as conflicting with the views of the court below in the instant case; on the contrary, we suggest that while separate entities were recognized in many of the cited cases, nevertheless, the several courts did examine the facts to determine whether or not the form was indicative of the substance of the particular transactions under consideration. In a number of cases the question was the right of the taxpayer to deduct certain losses or expenses under a particular section of the statute; in other cases the question was which of two taxpayers should be taxed upon income arising from a particular transaction. In all of these cases the courts were dealing either with actual income or actual expenses and losses, so that the question in the instant case was not presented. It is true that in these cases the courts held in many instances that the statutory provisions involved could not be met through a removal of corporate barriers, but we believe that an examination of the cases will reveal that in those cases in which the result followed the separate entity, the courts did examine first the facts and then in effect determined that those facts did not warrant a result other than that indicated by the form of the transaction. In other words, the form and the actuality were found to be identical.

In this connection we may cite a case of the same general type as those cited by the petitioner, but of more recent date, which is illustrative of our point, to wit, that cases of this type are fact cases. This case is *Industrial Cotton Mills Co., Inc.* v. *Commissioner,* decided on October 3, 1932, by the Circuit Court of Appeals for the Fourth Circuit (reported in Commerce Clearing House 1932, Vol. III, page 9297). A corporation formed by the merger of two other corporations was allowed to deduct in 1922 a net loss sustained by one of the merged corporations in 1921. The court recognized the separate legal entities of the new company and the old company, but, after examination of the facts, determined that under the particular circumstances the new corporation was in substance nothing more than the old corporation under a different name. This case might appear to conflict with *Planters Cotton Mill* v. *Hopkins,* 53 F. (2d) 825, affirmed in 286 U. S. 332, which is cited by the petitioner as being in conflict with the instant case. We submit, however, that there is no conflict between the two last mentioned cases, and further, that there is no conflict between the instant case and the cases cited by the petitioner in his brief. Cases in which the decision is made dependent upon the particular facts of each case

cannot be said to be in conflict or to establish precedent, one for the other.

If this is then purely a fact case, the facts and circumstances leading up to and evidential of the character of the actual transaction are of greater importance than decided cases on possibly related issues of taxation. Indeed, if we are right that the instant case must be decided solely on its own facts, then there could be no precedent except by extraordinary chance. With this thought in mind, we have set forth the facts in our Counter-Statement at much greater length than might be considered requisite in another type of case, and we confine our argument to those facts.

In brief, the respondent is in reality an integral part of the Estate of P. A. B. Widener. A portion of his securities were transferred to the respondent before his death in order, in his mind, best to make provision for a charity which he had created. It may be said from the record that his counsel was interested in then securing for Mr. Widener that freedom from multiple taxation on his death which this Court, twenty years later, in the case of *First National Bank of Boston* v. *Maine,* 284 U. S. 312, has held to be a right secured by the Fourteenth Amendment. Except as to

such inheritance taxation, there is no suggestion in the record that the respondent was organized or utilized by its owners to seek any other tax advantage or any other business advantage than to endow the charity, if such may be called a business advantage. As this one tax advantage was a result approved by this Court in the above case, the general criticism on page 10 of petitioner's brief with respect to individuals who seek to obtain the advantages of a corporation in their business affairs, and then later seek to avoid some tax or other obligation by disregarding the corporate entity, cannot be directed at the respondent or its owners.

The fact is that the respondent was not acquired to transact business in any commercial sense and has never been so engaged. It has held securities belonging to the Estate of P. A. B. Widener, and up until 1920 it provided through its own obligations an endowment for one of Mr. Widener's charities. Aside from current receipt and distribution of income, there were in 1917, 1919 and 1920 transfers of securities between it and the Widener Estate. The first two of these transactions were effected because the trustees thought that by so doing they would facilitate the administration of the estate as a whole. The last transaction was undertaken to make more secure the endowment for the charity.

No one of these transactions or readjustments were of a commercial or business character but were simply an incident in the administration of the Widener Estate and they resulted in no real profit to anyone.

The transaction in 1917 resulted in an apparent profit on the books of approximately $130,000., and the transaction in 1919 resulted in a loss of a like character amounting to approximately $167,000. In the trial of this case before the Board of Tax Appeals we offered to prove that the Commissioner of Internal Revenue had ruled that the profit was not a real profit and that the loss was not a deductible loss. We offered this evidence, not to establish anything in the nature of an estoppel, but because we believed that the opinion of the Commissioner with respect to similar transactions was relevant to the issue, to wit, whether or not the transaction in 1920 resulted in an actual profit.

With respect to the third transaction, which is the one in issue in this case, the Commissioner ruled that the profit created by his method of accounting, which in this instance was upwards of $1,000,000., was a taxable profit, and the Board of Tax Appeals sustained this view. The Court below reversed the Board of Tax Appeals because in its opinion, from which we quote below, there was under the facts no such real profit as was

taxable under the law as interpreted by this Court (R. 32, 33).

> **"Obviously, in actual dollars and cents, it made no difference to the estate, itself, whether or not they obtained anything in return; but in order to balance the books, the block of British-American Tobacco stock was taken, as its then value was substantially the same as on March 1, 1913, and was the largest single block standing in the taxpayer's name.**
>
> **"The stock was transferred and to offset the balance due the taxpayer on the exchange, it was given credit on its books. The result of the transaction produced no gain, nor loss, nor income to either the taxpayer or the Widener estate."**
>
> * * * * * * *
>
> **"The profit resulting to the taxpayer is illusory and non-existent. The law is interested in an income from which an economic benefit may be realized."**

We cannot by way of argument add to the conclusion of the Court below or to its view of the facts and their result. The net result to the Widener Estate was that it received back from the charity obligations of that part of the estate which was incorporated to the face value

of $4,000,000., and gave to the charity its own obligations, secured by mortgages upon certain real estate, of a like face value. The subsidiary transfer between the trustees of the estate and the incorporated portion of the estate, to wit, the taxpayer, was balanced by book entries as was the custom when it seemed desirable to shift funds or securities from the one hand to the other, and did not add or subtract one penny from the net worth of the estate or the taxpayer. Moreover, there was not only no actual profit, but it was the intention and was wholly within the power of the trustees so to mould the transaction that not only did the books record no profit, but the Commissioner could have claimed no taxable profit however he might interpret the law. The trustees in 1920 believed that the then Treasury Regulations correctly interpreted the statute and they acted accordingly, but they could as readily have then met the 1922 version of the Regulations, because to do so would simply have required the transfer of additional securities by the respondent.

If this assessment is sustained, then the trustees are chargeable with having reduced the principal of the trust by the amount of the tax, to wit, some $300,000. as a result of an unnecessary transaction. The transaction was unnecessary because the trustees could as well have held the

debentures as had them cancelled or they could have given the transaction any other form they chose. The tax will reduce principal because the trustees did not in any way increase their net worth when they accepted the British-American shares at the then market value. This transaction produced nothing more of substance as realized profit or income than if the trustees had caused respondent to make a note on its books that these shares were worth $1,000,000. more than tax cost.

To test this statement, let us assume that the trustees caused respondent to change its books so as to set up the Commissioner's version of this transaction, and thereby to increase its book surplus by $1,000,000. If this increase represented a true profit or earning to the petitioner, the trustees as directors could presumably declare it as a dividend, and on receipt by them as trustees, could and should distribute the dividend to those entitled to the income of the trust.

The courts of Pennsylvania have gone beyond most jurisdictions in advancing the interest of the life tenant in that, for instance, in *Nirdlinger's Est.*, 290 Pa. 457 and *Waterhouse's Est.* decided May 26, 1932 (not yet reported) it has been held that profits from the sale by trustees of corporate stock in the corpus of the trust are distributable as income to the extent that they represent earnings of the particular corporation which have

been accumulated since the inception of the trust. It is, however, an essential requirement of this rule that there be an actual *realization* of profit or gain. We, therefore, submit that even under the most extreme extension of this liberal Pennsylvania doctrine the trustees of the Widener Estate could not distribute the Commissioner's $1,000,000. profit as income because no such profit was ever in fact *realized* either by the respondent or by the estate. Even if we assume that the trustees as directors could legally declare a dividend from a surplus account so created, which is a question open to grave doubt, it is clear that they as trustees would receive from the respondent only a return of that which they themselves contributed from the capital of the estate because, in the interim between contribution and receipt, there was no actual *realization* by the respondent of the difference between tax cost and market value as there would have been had the British-American shares been sold by respondent in the open market.

The petitioner argues as a ground for reversing the lower Court that if this exchange had been between respondent and third parties a taxable transaction would have resulted. In this we agree, for in such case there would have been a *realization* of the appreciation equally with a sale in the open market as in our hypothesis

above. The answer is, however, that in the instant case there was no such exchange or sale; respondent was in fact an integral part of the Widener Estate and an instrumentality in the administration of the trust even though in general legal theory the two parties were separate entities; and that by no test or doctrine based on substance and actuality did there result from this transaction a gain or profit which may truly be called income.

II

The Commissioner's Determination of a Profit is Not Warranted by the Statute.

We have printed on page 3 of this brief, Article 39 of Regulations 45 as it stood during 1920 and on page 4 the same Article as amended in 1922. This Article is an interpretation of Section 202 of the Revenue Act of 1918. It is our position that the Article on which we relied in 1920 in selecting the securities to settle the transaction, is a correct interpretation of the statute, and that the later amendment endeavors to substitute an accounting method which is not warranted by legislative authority.

The Court will recall that the 225,000 shares transferred by the respondent in 1920 were acquired prior to March 1, 1913, that is to say, the actual certificates delivered in 1920 were the

identical certificates received by the respondent on May 1, 1912. As of March 1, 1913, these shares had a value of $5,315,625. They were transferred in 1920 for an expressed consideration of $5,287,500. In 1919, the respondent received rights to subscribe for 75,000 additional shares and took up these rights at a cost of $326,437.50. The Commissioner added this latter item to the March 1, 1913, value and divided the result by 300,000. He thus obtained a tax cost per share of $18.80 and on this basis figured a profit of $1,055,953.12 on the transfer of 225,000 shares in 1920.

The determination of a profit or loss from this transaction is ruled by Section 202 (a) of the Revenue Act of 1918, which is as follows:—

> "SEC. 202. (a) That for the purpose of ascertaining the gain derived or loss sustained from the sale or other disposition of property, real, personal, or mixed, the basis shall be—
>
> "(1) In the case of property acquired before March 1, 1913, *the fair market price or value of such property as of that date;** and
>
> "(2) In the case of property acquired on or after that date, *the cost thereof;** or the inventory value, if the inventory is made in accordance with section 203."

* Italics ours.

The Court will note that we are concerned both with sub-sections (a)-1 and (a)-2 as the first applies to the 225,000 shares acquired before 1913 and the second applies to the 75,000 shares acquired thereafter. We submit that this provision is clear and unambiguous, and that the tax basis of the 225,000 shares cannot be anything other than March 1, 1913, value and that the tax basis of the 75,000 shares cannot be any other than cost. Whatever the Commissioner's reasons may be for mixing the two bases and thus arriving at an average cost for both classifications of stock, his regulations and ruling to such effect are invalid under the doctrine of *U. S.* v. *Merriam,* 263 U. S. 179; *Smietanka* v. *First Trust and Savings Bank,* 257 U. S. 602; and *Gould* v. *Gould,* 245 U. S. 151, as being an administrative attempt to vary a legislative enactment.

It is of interest to note that the Commissioner has adhered rigidly to the language of the statute when successive lots of stock are purchased at different prices; that is to say, when 100 shares are bought at $100, another lot of 100 shares at $150 and a third lot at $200, the Commissioner does not consider that the 300 shares have a tax cost of $150 per share. It might be sound from a business viewpoint if he did because an investor considers that in such circumstances he has 300 shares of stock which cost him $150 per

share and he acts accordingly. The Commissioner, however, does not accept this business fact and we submit that he could not under the statute. Instead, it is his ruling that the taxpayer may sell any one of the three lots on a tax basis of actual cost provided he can identify the lot he sells as being the lot bought at a particular price: if he cannot so identify his deliveries he must assume that the first stock bought is the first stock sold, so that to follow our illustration, if the investor first sold 100 shares at $150 he would make a tax profit of $50 per share on that lot notwithstanding his second and third purchases.

So far as we know, the only exceptions which the Commissioner has made to this general rule are when additional shares are received by way of stock dividend and when they are acquired by subscription as in the present case. The position of shares received by way of dividend and those purchased by subscription may be distinguished in that in the latter case the additional shares are and can only be acquired by the taxpayer at a specific cost, and being thus acquired, they come definitely under the exact language of the statute.

The Commissioner's rule has been approved in *Ayer* v. *Blair,* 25 F. (2d) 534, and in *Hewes* v. *Eaton,* 39 F. (2d) 917, but with due respect

to those courts we can find no reasoning in their opinions which justifies the decisions. The Commissioner was allowed to deviate from the statute on the theory that the shares first purchased were not in contemplation of law the shares sold, although the original certificates were delivered to complete the sale. It was said that the parties to the sale were not dealing with paper certificates but with proportionate interests in the ownership of the corporation. We concede that a stock certificate is only an evidence of the ownership of a share of stock, and that from an academic viewpoint, a share of stock may be considered as intangible property carrying certain privileges which include an undivided interest in profits and assets of the corporation. But we cannot concede even as a general academic theory that if and when additional shares are issued, the shares before issued are transmuted into different shares. The proportionate interest of each share in the so-called "equity" is reduced and the *intrinsic* value of each share is lessened; but they remain the same shares as before the increase, even though they may be dealt in, as between seller and purchaser, at a reduced price. It may also be sound to consider that in determining cost to the stockholder, the cost of all the shares should be averaged, but there is no more reason why this should be done in the

case of subscription stock than in the case of successive purchases of shares.

Upon analysis, it is clear that this question is purely one of accounting. Under the accounting method prescribed by Congress the criterion is *cost* and not *average cost* or *intrinsic value.* It may well be that either of the latter two would be a sounder method of computing a profit in a particular transaction, but the answer can only be that Congress has prescribed otherwise. The fallacy in *Ayer* v. *Blair* and in *Hewes* v. *Eaton* is that the Court in each case has permitted the Commissioner to change the accounting method prescribed by Congress to a method which to him appeared more desirable.

In the *Ayer* case the Court appeared to lean upon the decision of this Court in *Miles* v. *Safe Deposit Company,* 259 U. S. 247, and this case is in fact usually relied upon as supporting a deviation from the statute in the case of stock acquired by subscription. We believe that the *Miles* case is not an authority in the present issue. In that case, the stockholder sold his rights; the Commissioner attempted to tax the whole proceeds as income; and the Court took a middle ground in that it prescribed a formula by which some part of the cost of the original shares was allocated to the rights in

determining how much of the proceeds of their sale could be considered as taxable income. We submit that this is a very different situation from the case now before the Court. In the *Miles* case there was no question of the purchase of additional shares and no element of cost to the taxpayer. Therefore, the facts were not exactly governed by the statute as they are in our case.

The Court in the *Miles* case gave relief to the taxpayer on the theory that the proceeds of the sale of the rights, while apparently income, was not all income in fact and in substance, because to acquire the rights the taxpayer had first to purchase shares in a particular company. We submit that that reasoning has no application when the taxpayer has not sold his rights but has subscribed. In this latter situation he has not received cash apparently at no cost, but on the contrary, he has paid a definite price for the shares received. It may be that he would have had to pay more had he not made his original purchase, but we cannot agree that there is such transmutation of property by virtue of the additional issue as to reconcile the ruling and the statute. In the instant case, it is conceded that the first block of shares cost 23⅝ per share and the second cost 4.34 per share. Those are the facts, and we submit that the statute should

be applied to those facts without variation, so that the tax basis of the 225,000 shares transferred in 1920 is 23⅝ and the tax basis of the 75,000 shares purchased in 1919 remains at 4.34 against such time as the respondent may dispose of the same.

CONCLUSION.

It is respectfully submitted that the decision of the Court below should be affirmed.

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SUPREME COURT OF THE UNITED STATES.

No. 95.—October Term, 1932.

David Burnet, Commissioner of Internal Revenue, Petitioner, *vs.* Commonwealth Improvement Company.	On Writ of Certiorari to the United States Circuit Court of Appeals for the Third Circuit.

[December 12, 1932.]

Mr. Justice McReynolds delivered the opinion of the Court.

Respondent—Commonwealth Improvement Company—all of whose shares are owned by the Estate of P. A. B. Widener (he died in 1915), made return concerning income and excess profits taxes for 1920 wherein it claimed deduction for loss occasioned by transfer of British-American Tobacco Company stock to the Estate. The Commissioner refused to allow the deduction and found that rightly regarded the transaction had yielded gain to the taxpayer. A deficiency assessment followed.

The Board of Tax Appeals approved the Commissioner's action; but the Circuit Court of Appeals, Third Circuit, held otherwise.

Having acquired control of the Commonwealth Improvement Company, incorporated under an old Pennsylvania charter, Mr. Widener caused an increase of its capital stock and authorization of $20,000,000 script and debentures. He then—May 1, 1912—conveyed to the corporation sundry stocks valued at $25,000,000 taking in payment all its shares and $20,000,000 in debentures and script. He was old and the double purpose was to avoid multifold death duties or transfer taxes and to insure the safety of an endowment which he wished to donate to a favorite charity—School for Crippled Children. $4,000,000 of the debentures so received were promptly deposited in trust for the benefit of that School.

Among the securities transferred by Widener to respondent were 225,000 shares British-American Tobacco Company. Their market value March 1, 1913, was $5,315,625—$23.625 per share.

In 1919 the Improvement Company, under privilege extended to stockholders, subscribed for and received 75,000 new shares then issued by the British-American Company. Paying therefor $326,437.50—$4.3525 per share—much less than market value.

In 1920 the trustees of the Estate acquired the $4,000,000 of respondent's debentures theretofore deposited for benefit of the School. These were transferred to respondent and in part payment it transferred to the Estate the original block (the identical certificates) of 225,000 British-American Tobacco Company shares valued at $5,287,500—$23.50 per share. The apparent result was sale of the whole block at twelve and one-half cents per share under the March 1, 1913, value with consequent net loss of $28,125.00. For this sum respondent claimed deduction upon its 1920 tax return.

When the Commissioner audited the return he decided that the base value per unit (for taxation purposes) of the 225,000 shares British-American Tobacco Company, transferred as shown, should be ascertained by adding to their total market value March 1, 1913 —$5,315,625.00—the total paid for the 75,000 shares acquired in 1919, $326,437.50 and dividing the resulting sum by 300,000. The quotient, $18.806,875, he held was the base cost of each transferred share. Accordingly, he found a gain by respondent of $1,055,953.12 and made an appropriate deficiency assessment.

In brief and argument here respondent advances two points. First, it is said the Commissioner improperly reckoned the base value of the British-American Tobacco Company shares. Second, that under the peculiar facts of the cause the transaction under consideration resulted in no true loss or gain. Respondent was merely the agency or instrumentality of the trustees of the Estate in administering their trust. Practically considered, the Improvement Company and the Estate are the same entity.

The Board of Tax Appeals expressed no opinion concerning the Commissioner's method of reckoning—it was not requested so to do. There the respondent relied entirely upon the second point. The Circuit Court of Appeals ruled only on the same point. In such circumstances, we do not undertake to determine what was not considered below.

Upon the second point we think the Board of Tax Appeals reached the right conclusion; the judgment of the Circuit Court of Appeals must be reversed.

Among other things, the Board well said—

"The petitioner does not now argue before the board that the method of computing the gain was incorrect, but relies entirely upon its contention that the corporation and the estate are the same entity. If this contention were logically applied it would follow that all income received by the corporation since its organization was properly taxable as income of P. A. B. Widener and his estate and should have been added to any other income which Widener and his estate received during these years and taxed at the rates applicable to individuals rather than returned by the petitioner and taxed at the rates fixed for corporations. For the purposes of inheritance and transfer taxes imposed by the various States upon the transfer of the stocks owned by petitioner the corporate entity should have been disregarded upon the death of Widener and these stocks subjected to whatever taxes would have been payable had they been owned by the decedent. But petitioner does not seek to carry its contention to such a conclusion. Having enjoyed the benefits which resulted from its separate existence, it seeks to perpetuate those benefits and asks that the separate existence and tax liability of the petitioner and its single stockholder be overlooked only with respect to transactions which take place between them. That this is an afterthought is plainly evidenced by the action of petitioner in claiming a deduction upon this same transaction when it believed a deductible loss had been sustained. . . .

"The fact is that petitioner did have a separate legal existence with privileges and obligations entirely separate from those of its stockholders. The fact that it had only one stockholder seems of no legal significance. *Cannon Mfg Co.* v. *Cudahy Co.*, 267 U. S. 333."

Counsel for respondent concede that ordinarily a corporation and its stockholders are separate entities, whether the shares are divided among many or are owned by one. Consequently, they make no effort to support any general rule under which a corporation and its single stockholder have such identity of interest that transactions between them must be disregarded for tax purposes. They submit, however, the peculiar facts here disclosed

suffice to show there was really no income, nothing properly taxable as such. They refer to *Southern Pacific Company* v. *Lowe*, 247 U. S. 330 and *Gulf Oil Corp.* v. *Lewellyn*, 248 U. S. 71, not as controlling but as instances where the court looked through mere form and regarded substance.

While unusual cases may require disregard of corporate form, we think the record here fails to disclose any circumstances sufficient to support the petitioner's claim. Certainly, the Improvement Company and the Estate were separate and distinct entities; the former was avowedly utilized to bring about a change in ownership beneficial to the latter. For years they were recognized and treated as different things and taxed accordingly upon separate returns. The situation is not materially different from the not infrequent one where a corporation is controlled by a single stockholder. See *Eisner* v. *Macomber*, 252 U. S. 189, 208, 209; *Lynch* v. *Hornby*, 247 U. S. 339, 341; *United States* v. *Phellis*, 257 U. S. 156, 172, 173.

Southern Pacific Company v. *Lowe*, *supra*, and *Gulf Oil Corp.* v. *Lewellyn*, *supra* (the latter covered in principal by the first), cannot be regarded as laying down any general rule authorizing disregard of corporate entity in respect of taxation. These cases presented peculiar situations and were determined upon consideration of them. In the former this court said—"This case turns upon its very peculiar facts, and is distinguishable from others in which the question of the identity of a controlling stockholder with his corporation has been raised. *Pullman Car Co.* v. *Missouri Pacific Ry. Co.*, 115 U. S. 587, 596; *Peterson* v. *Chicago, Rock Island & Pacific Ry. Co.*, 205 U. S. 364, 391."

Reversed.

A true copy.

Test:

Clerk, Supreme Court, U. S.